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THE NATIONAL DAIRY PROGRAM

HEARINGS

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE REPORT OF THE NATIONAL COMMISSION ON DAIRY POLICY

AND

S. 1869

A BILL TO AMEND THE AGRICULTURAL ACT OF 1949 TO PROTECT THE FAMILY DAIRY FARM BY ESTABLISHING A REGIONAL DAIRY PRODUCTION STABILIZATION PROGRAM, AND FOR OTHER PURPOSES (DAIRY FARM PROTECTION ACT) AND REGIONAL PROBLEMS IN THE DAIRY INDUSTRY AND MILK MARKETING ORDERS

APRIL 28 AND MAY 11, 1988

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[1] As of May 11, 1988, James M. Cubie became Chief Counsel.

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THE NATIONAL DAIRY PROGRAM

To Receive Testimony on the Review of the National Commission on Dairy Policy Report

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THURSDAY, APRIL 28, 1988

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9[illegible]8 a.m., in room 332, Russell Senate Office Building, Hon. Patrick J. Leahy (chairman of the committee) presiding.

Present or submitting a statement: Senators Leahy, Melcher, Conrad, Daschle, Boschwitz, McConnell, and Bond.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. Good morning. Today, we have changed somewhat the order of the witnesses, partly because of the notice we got from the Senate as to when votes are going to be, and also because we may have to interrupt part of the hearing today because of a meeting several of us have with Prime Minister Mulroney of Canada who is here.

The Prime Minister has asked a number of us, especially those from some of the Northeastern States, to come and talk about acid rain with him. This is a subject where the border quickly disappears between the United States and Canada, especially in our part of the country, and where we intend to spend a lot of time talking with the Canadians about acid rain, and about our hopes in the Northeast of doing something about this problem.

We are going to start, though, right after I give a short opening statement, with the Honorable Robert Starr, who is the chairman of the House Agriculture Committee of Vermont. I would tell Senator Bond of Missouri that it is just a coincidence that we have Representative Starr and Representative Duffy, who is the vice-chair of the House Agriculture Committee.

We had to pick from one of the legislatures of the 50 States, and so we went alphabetically and started with Vermont. It has nothing to do with the fact that I am chairman of the committee.

Senator BOND. I understand that fully, Mr. Chairman, and some day in the future we may start with Missouri being the first of the alphabet, but I am delighted to join you in welcoming the distinguished elected officials from Vermont, and we are most interested to hear their comments.

The CHAIRMAN. I should note that the distinguished Senator from Missouri suggested some witnesses on another subject, from Missouri, to come and testify before one of our panels, and I look forward to receiving their testimony.

The Senator from Missouri has made very clear that his State also gets heard here, and does, and to the benefit of the whole committee.

Senator BOND. Well, Mr. Chairman, if I may interrupt, I would say that one of the most beneficial trips that we took last year was to visit Vermont. We were most impressed by what we saw in your wonderful State. The hospitality and the excellent food made it a personally satisfying trip, but we also gained a great deal from talking with your constituents and we appreciate the chance to hear more.

The CHAIRMAN. Thank you very much.

I welcome everyone to the first of two hearings on our national dairy program. The second hearing will be on May 11.

Today, we are going to consider the recent report of the Dairy Policy Commission. In fact, Mr. Rutherford, the chairman of the National Commission on Dairy Policy, will testify after Mr. Starr. I am glad to see you here this morning.

The Commission was authorized in the 1985 farm bill. It had a broad task: to assess the value of the current price support system and to propose policy for the future.

We are grateful for the hard work and dedication that went into the report, both by the Commission members and by the Commission staff. Now anybody interested in dairy policy in this country should study and read that report.

I have looked at the report and I have read it with a great deal of interest. I have found some inconsistencies, and I must say, some disappointments. The Commission spent considerable time deciding that they could not determine what a family farm is, even though several organizations provided them with definitions. Certainly this committee would have been happy to have done that.

The report states that price should be used to control supply and demand, but it also calls for supply control. Why not simply use supply control? I think the two calls are inconsistent. It should be one or the other.

The report discusses paying for whole herd without assessments, but today's budget process would not allow the suggestion to be implemented, a fact they knew when the recommendation was made.

The report also fails to discuss how to prevent a race for base or how the value of the base would be bid into the cost of production.

Now I could go on and on with this list, but these are questions I would have liked to have seen answered, and they were not.

I am also concerned that the report does not respond to a major policy question. What type of policy would preserve an active dairy and dairy products industry in this country, but to preserve it in all parts of the country, not just in one or two? Because I must say, while I head up this panel and we have to consider national policies, I am still, first and foremost, a Senator from Vermont. I care about the dairy farmers in Vermont and throughout the Northeast.

The recent action in the Vermont State Legislature showed the broad base of support for farmers in our State, and I want to see that our milk producers have a fair chance to continue farming, and I will fight for that.

As we move toward the 21st century, if we want to have dairy farming in this country and have it broadly diversified, we need an aggressive and progressive dairy policy, one that keeps a broad geographic dispersion, a policy that keeps the manufacturing sector viable in all of these regions as well.

Now I do not see new ideas in this report to do that. The Congressional Research Service notes it raises as many questions as it answers, and that may well be a valuable part of it, but as I said there are inconsistencies in the recommendations.

I am concerned that not enough thought has been given to how new technologies are going to affect the price-support program.

Now I do not see eye to eye with the Commission on this, and some other points in the report, but I am going to keep an open mind as we begin the discussion today.

I should also note, however, that I have a great deal of respect for Mr. Rutherford and for the members of the Commission. They have worked very hard. I am concerned, however, that this does not grapple hard enough with the very, very difficult problems of trying to establish a national dairy policy.

It is easy to get a dairy policy that just takes into account a couple regions of this country. It is far more difficult if we want to have a national one.

I think it is the mandate of this committee to look, first, at the ability to have national agricultural policies, whether in dairy or other agricultural programs. If because of geography, weather, or something else, some agriculture does not allow itself to be of a national nature, well, that is different. Certainly the citrus industry is one that comes to mind because of weather. But dairy I think is different.

Before we go to Chairman Starr, I want to yield to my good friend from Missouri, Senator Bond.

[The prepared statements of Senator Leahy and Senator McConnell follow:]

PREPARED STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

HEARING ON THE NATIONAL COMMISSION ON DAIRY POLICY REPORT—APRIL 28, 1988

I want to welcome you all here today for the first of two hearings on our national dairy program.

Today, we consider the recent report of the Dairy Policy Commission. This Commission, which was authorized in the 1985 farm bill, had a broad task: to assess the value of the current price support system and to propose policy for the future.

We are grateful for the hard work and dedication of all the Commission members and staff. I know that all the members of the committee will study this report carefully.

I must add, however, that I have looked at the report and found several inconsistencies and some disappointments. The Commission spent considerable time deciding that they couldn't determine what a family farm is, even though several organizations provided them with definitions.

The report states that price should be used to control supply and demand, but it also calls for supply control. Why not simply use supply control?

The report discusses paying for whole herd without assessments, but today's budget process precludes doing so, a fact the Commision was aware of when they made the recommendation.

The report also fails to discuss how to prevent a race for base or how the value of the base would be bid into the cost of production.

In short, there are no new ideas in this report. As the Congressional Research Service notes, it raises as many questions as it answers. There are inconsistencies in the recommendations. I am also concerned that very little thought has been given to how new technologies will affect the price support program.

Dairy farmers are the hard-working heart and soul of Vermont. Following current policy threatens to put many dairy farmers permanently out to pasture.

We care about our dairy farmers in Vermont. I will continue to fight to see that they and others like them across the Nation have a fair chance to make a decent living.

All dairy farmers are in this together. As we move toward the 21st century, we need a progressive dairy policy that responds to the unique needs of each region of this country, to the benefit of all and the detriment of none.

I realize that the Commission does not see eye to eye with me on the direction of future dairy policy. But I am here with an open mind and the firm belief that a dialogue is more than two monologues. We must maintain the exchange of views and ideas as we continue to work together toward a fair and equitable national dairy policy.

PREPARED STATEMENT OF HON. MITCH MCCONNELL, A U.S. SENATOR FROM KENTUCKY

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY—APRIL 28, 1988

Mr. Chairman: I want to begin by expressing my thanks to the distinguished chairman of this committee. The discussion today I think shall be very worthwhile, especially as 1990 draws near. What course our Nation's dairy policy should take has the potential to become one of the most divisive of the 1990 farm bill debate. The sentiments surrounding this issue are very strong indeed, and defy the hope of easy consensus.

I supported the dairy provisions of the 1985 farm bill, not because I thought they represented the perfect solution, but because they represented the fairest possible compromise which could be achieved for the whole of the dairy industry. We attempted to control supply through a reduction of excess capacity. Beyond that we imposed an orderly exposure to the market, mandating price cuts if excess supplies remained after a reasonable period of time.

Compromise is an effort to appease, an attempt to resolve conflict. Unfortunately, with the dairy provisions of the 1985 farm bill, I think we only managed to temper the conflict somewhat. The supply problem has lessened considerably, but the whole-herd buyout was not able to avoid the triggered price reductions, or the scrutiny of the cameras of "60 Minutes". Production continues to explode in the Western United States, while my part of the country is forced to ship in milk. We face the very real possibility of another $.50 reduction in price in the not too distant future. While the 1985 farm bill provided some success, profound problems refuse to go away.

Two policy alternatives frame the spectrum of our options for 1990—the inflexibility of mandatory supply controls and the harsh discipline of the marketplace. In Washington, there is an overwhelming proclivity toward "study", and rather than make the choice between these two options in 1985, Congress did the brave thing and mandated a study to complement its dairy program changes. Seriously, I am pleased that the report of the National Dairy Policy Commission is complete—I think it will give us a clearer view of the problems facing the dairy industry, and will provide an excellent starting point for the 1990 debate. I commend the individuals involved in this study and thank them for their time and effort.

Clearly the dairy industry faces overwhelming challenges. The growth hormone bovine somatotropin could increase per cow production by as much as 4,000 pounds annually. Improvements in genetics and management techniques will continue to drive production up. I am not convinced that any of these things are inherently bad, but they are very real challenges which must be dealt with. Regional differences separate this industry on the issue of what the appropriate Federal response should be, and as a result this committee has its work cut out for it. I welcome this hearing as a positive start to what promises to be an interesting debate.

Again, I thank the Chair, and I look forward to the testimony of today's witnesses.

STATEMENT OF HON. CHRISTOPHER S. "KIT" BOND, A U.S. SENATOR FROM MISSOURI

Senator BOND. Thank you very much, Mr. Chairman.

It was about this time last year when all of us interested in agriculture, and the agriculture community were questioning the fate of the National Commission on Dairy Policy.

If I remember correctly, the director and staff were not even hired until shortly before the date the Commission's report was to be submitted to Congress, so the Commission itself has been laboring under some external pressures that were not of their making.

And there were some who were actively wondering whether Congress would extend the deadline or simply ignore that section of the farm bill.

Looking back, it is safe to say that Congress has not changed in the past year, we are still running a few months behind.

It was with great anticipation that I awaited the Commission's report. In fact I am still waiting. I do, however, have a copy of the executive summary, and they told me that that is all I need to read.

Given the questions that the chairman has raised, and that we all have, I think maybe we would want to go a little bit further than just the summary.

If you will permit me, Mr. Chairman, as a Senator from Missouri, I am proud to state that I represent a State which, in 1986, had the 6th largest number of dairy operations, the 10th largest number of milk cows, the 11th highest milk production, and one of the largest dairy cooperatives in the country.

In other words, I will always have a vital interest in dairy policy. I see our good friend and colleague from Minnesota has joined us, and I am sure he will raise the ante when he has his chance for comments.

Mr. Chairman, I believe the committee knows how difficult it is to get any kind of consensus among agricultural groups, especially when they do represent different geographic areas.

The National Commission on Dairy Policy is comprised of 18 dairy producers from across the country. It was able to produce a set of recommendations which all its members could support.

This, in and of itself, is no small undertaking as the dairy industry will no doubt have to make some very difficult decisions in the years ahead.

Continued advances in technology, again—as the chairman has pointed out—possible further price cuts, changes in consumption patterns, decreasing numbers of farms, and continued shifts in geographic production patterns will all have to be addressed.

I am pleased that we do have a beginning, something to work on. I hope that the Commission can give us some guidelines.

Mr. Chairman, I particularly commend you for holding this hearing so soon after the report was released, for raising some of the questions that need to be addressed. We hope to be able to utilize this opportunity to initiate a constructive dialog, and as Members of Congress, we are going to have to read this report and come up with some of the difficult answers that you suggested lie ahead.

The CHAIRMAN. Thank you very much, Senator Bond. Senator Boschwitz, I notice you have come prepared for this. You are wearing your Holstein belt buckle.

Senator BOSCHWITZ. Thank you very much.

The CHAIRMAN. And it was probably made in Vermont, but did you want to say anything before we start?

Senator BOSCHWITZ. No. I think I would just like to start.

The CHAIRMAN. Thank you. Well, then we will turn to you, Representative Starr. It is always good to see you. You and your vice chair have had probably the busiest time your committee has ever had in the Vermont Legislature, with the question of what the legislature will do with the decline in dairy farms, and with almost certain further Federal cuts, I know this has not been an easy time for you at all.

I look forward to your testimony. Please proceed.

STATEMENT OF ROBERT A. STARR, JR., CHAIRMAN, HOUSE AGRICULTURE COMMITTEE, VERMONT HOUSE OF REPRESENTATIVES, MONTPELIER, VT, ACCOMPANIED BY JEAN ANNE DUFFY, VICE CHAIRMAN, VERMONT HOUSE OF REPRESENTATIVES

Mr. STARR. Good morning. Well, thank you, Senator. It is indeed a pleasure to be here in Washington to testify on this National Dairy Report. I should make a brief statement that we enjoyed having Senator Bond in Vermont last year, and I am sure that he enjoyed looking over the State of Vermont, and probably gained some of the love and care that we, as Vermonters, think about our State.

My testimony is going to be basically based on Vermont's perspective of the Commission's report, and it will work in a little bit to the northeastern region.

So with those remarks, I will start with my prepared testimony.

Vermont's motto proclaims our State the home of "Freedom and Unity." It is a fitting epigram, one that sums up aptly our experience as a State and as a people. We Vermonters love our State, prize its unique qualities, and do not want to lose them. The people of Vermont and its General Assembly are saying, "The beauty and quality of life in Vermont are not for sale or destruction; if anyone tries to jeopardize this, they had better be ready for a fight."

Agriculture is the foundation of our economy and culture. Farming has shaped our beliefs and attitudes as well as our countryside. The work ethic that distinguishes Vermont workers was honed on the family farm, as were independence and self-reliance that we all value and cherish so much today. Small farms enhance the beauty of our countryside in a way that nature cannot reproduce.

Vermonters, as well as the Vermont legislators, have expressed a strong desire to see dairy farming remain a part of Vermont's character. There are many reasons for this strong support. For some, it is the economic contribution that agriculture makes to our State's economy: $600 million per year in direct revenues and three to five times that amount when the multiplier effect is considered.

For still others, it is agriculture's contribution to the food requirements of New England: 40 percent of region's fluid milk is produced in Vermont.

Recent initiatives in the Vermont Legislature have demonstrated how important we believe agriculture is to the State's economy and character. The general assembly has gone to great lengths to help relieve some of the pressures on our farm families, and to look to a future of open land, conservation of resources, and a way of life we all value. So it is with mixed feelings that I read some of the recommendations of the National Task Force on Dairy Policy, which report was issued late last month in Washington. I quote from page 13 of the report. "States should not act independently to avoid the consequences of Federal policy programs." End of quote. I strongly disagree with this statement, which appears to suggest that Vermont cooperate with the Federal Government's slow strangulation of our dairy farms. We do not intend to give up our dairy farms without a fight.

We understand that the Commissioners worked earnestly and hard on this report. We understand that they are recommending broad guidelines for a long-term Federal policy. We also understand that the report is national in perspective, and must address the realities of a very large and complex national economy. But we believe some of the recommendations and position statements are inappropriate and run counter to our interests and those of other Northeastern States. The Commission members, for example, oppose regional dairy policy. We have favored a design for a dairy policy that takes regional differences into account. The Governor of Vermont has taken that message to her fellow Governors at the National Governors' Conference and they concurred.

The report specifically discourages States from offering cash payments on milk production—a direct shot at Vermont—but we have worked hard to secure a temporary premium payment of 50 cents per hundredweight for our farmers as a sign of support to relieve some of the financial pressure in an era of falling milk prices. The purpose of this is not to encourage production, but to maintain cash-flow in the face of dropping prices. That premium, and other measures under consideration by our legislature are aimed at staving off what Federal policy explicitly aims to do: put more of our farms out of business.

The people of Vermont want a viable agricultural sector, and in this they are saying things no different than from the residents of other States. We have joined with legislators in the State of New York to explore forming a dairy compact to bring fair prices to the farmers throughout the Northeast. We hope to involve other States, of course, in our region, where the erosion of farm income and the agricultural infrastructure are major concerns to all of our dairy farmers.

We want nothing more than fairness in milk pricing. It is not fair when the price to the farmer drops while the price the consumer pays rises, as has been the case and still is. It is not fair to insist on a policy of uniformity where regional differences do not accommodate uniformity. It is not fair to write off dairying in Vermont—as the Commission's report correctly points out—California farmers overproduce with impunity.

We can agree with some of the things in the report. We were pleased, for example, that the report called for improvements in the Federal milk market order program. We also agree that production controls might be needed to balance supply and demand. This is especially true in the era of technological revolution that is hard upon us.

But we feel uncomfortable with statements like this: "Targeting benefits to a particular size or structure of farm is inefficient and undermines the basic purpose of the Federal milk price support program." On the contrary—in our view, the Federal price support program, as it operates now, is inefficient, inequitable, and has undermined the family farm in Vermont as well as the whole Northeast. A uniform pricing structure, formulated without regard to its effect on different regions, would serve to drive out countless numbers of farmers. The demand for milk may be served, but the desire to have farmers as members of our communities may very well be profoundly diminished.

The dairy industry is composed of a legion of individuals, and their individualism should be cherished and nurtured as a vital part of our national heritage. The legislature in my State is responding to the demands of its people to do just that, and our national Government should do no less. I ask that you reject the report's call for a dairy policy which is infused with the sterile blood of uniformity in the name of economic efficiency, and pursue instead a regional policy that is responsive to the experience and desires of the diverse regions of this country. Thank you.

The **Chairman**. Thank you very much, Bob. I should note both for Senator Boschwitz and Senator Bond, that Vermont, as so many other States, has a truly citizen legislature. We do not have any full-time legislators.

That you leave your business, as Vice Chairman Duffy does, to come to Montpelier, and do most of your work without staff, without offices, but with the kind of integrity that the general assembly has always shown, is appreciated.

As we sit here and we debate dairy policy, we see States like Vermont, and others, taking action of their own, their own State legislatures, involving themselves with farms, whether farm price supports, subsidies, or whatever.

Do you think it is appropriate for a State to take such action to support their farms?

Mr. **Starr**. Well, I certainly do, and if the members of the Commission had read the President's Federalism proposal, they would not even have wrote the report as they wrote it. I mean, it is in contrast to what the President's Federalism is all about.

I do not agree with President Reagan on hardly anything, but that particular issue I do agree upon, and of course in that position, I think States and regions should do, and should be able to do anything and everything that they can afford to do to preserve their way of life.

We in Vermont are not acting any different to our farmers than we would as if a $600 million industry was leaving the State.

If IBM was pulling out of Vermont, we would be doing everything in our power to help them stay. I really disagree with the report's position that we should just sit back, read the auction ads, and see the developers move in and plant condominiums in our corn fields. Well, we are not going to take that.

We are spending—in Vermont we have a $635 million budget in the State. We are spending $60 million this year on farm programs, over 10 percent of our budget.

Senator BOSCHWITZ. That is less than 10 percent.

Mr. STARR. Pardon?

Senator BOSCHWITZ. That is a little less than 10 percent.

The CHAIRMAN. Over $60 million he said.

Mr. STARR. Yes, we are spending over $60 million.

Senator BOSCHWITZ. You said over. All right.

Mr. STARR. Yes.

The CHAIRMAN. That is in retail, always in retail.

Senator BOSCHWITZ. You bet.

The CHAIRMAN. Relax there, Rudy. [Laughter.]

Mr. STARR. I do not have a calculator up here, but anyhow, when we had this vote in the Vermont Legislature on the premium bill, out of 150 members, 110 supported it.

And I think there are 22 farmers in the legislature. It was the Burlington vote, the Rutland vote, the Bennington vote, the Brattleboro vote——

The CHAIRMAN. The urban votes.

Mr. STARR. That is right. [Laughter.]

I cannot see any State just watching the dairy farming community just die, without moving in and doing something. I am proud that we are helping out, and I should think Washington would be glad that we are helping out.

The CHAIRMAN. Bob, what price—you know—it all comes down to the bottom line, and we know that there are good farms and bad farms and just like in any business, there are some who just cannot handle the burden no matter what the price is, there are some people who are not going to stay in business.

But assuming you have people who are willing to work, take the appropriate measures to run their farms, who are willing to use good farming and marketing methods, what price do they need for their milk to stay in business in our State?

Mr. STARR. Well, from all the reports that I have read, it costs Vermonters about $12.75, or it costs about $12.75 to produce a 100 pounds of milk.

So if that is what the experts say it takes, I would say Vermonters can make milk for $12 and do darn well at it.

If they said it took $10, we could make milk for $9.50, but in Vermont, I think if our farmers receive $12 to $13 they would do very well, and as you said, we still have a few farmers that probably should not be farming, but we have very few.

Most of these guys were weeded out in the diversion program, and the whole herd buyout, and with the price-support reductions it has knocked out the rest of them.

So, most of our farmers are very sincere and dedicated, and they plan to stay in.

The CHAIRMAN. Would it be fair to say that in the last 10 years, with the changes in our State, we have seen the inefficient farmers, or those who should not be farmers, taken out of the system?

Mr. STARR. Most of those people are gone.

The CHAIRMAN. Mrs. Duffy, is that your feeling, too?

Mrs. DUFFY. Yes, sir. I certainly agree with that. Considering the price-support cuts that we have had in the past 2 years, and considering the pressure to not overproduce, the pressure for reduction through diversion and whole herd buyout, and just trying to stay afloat and pay your bills with the prices that we have had in the last 2 or 3 years, certainly, if you are still there, you are a creative manager. You are doing all the right things, or you would not be able to be there any longer.

The CHAIRMAN. Well, what should the Federal policy be? Vermont obviously cannot spend 10 percent of their budget. Bob, you have your trucking company, and you are going to start hearing demands for money for highways, and whatnot. Jean, you have your farm, but you are still going to hear demands for other things as a legislator. We cannot keep on at 10 percent there. What should we change in the Federal policy?

Mr. STARR. Well, it seems crazy to me, that any Federal policy that you have is set up like diversions, or controls, supply control. When you, as the Federal Government, set this up, you set up across the Nation. Well, that seems crazy to me.

If I had regions of this country, and I was sitting where I had some control over the whole country, and the problem was in the Northeast, that is where I would direct my attention. If it was in the Far West it would be there. Or in the Southeast, it would be there.

It is crazy to pay farmers to go out of business in Vermont when our co-ops are begging for milk. We have one co-op that is looking for 50 farmers, 50 farms, and so that is why I stress this regional thing.

I do not know a lot about the milk business. I am sure you folks forget more every day than I will ever know about it. But as a businessperson, if I have 10 customers and I am having problems with 1, I do not doctor all 10 of them. I work on that one problem. And I should think, if there is an oversupply of milk in a particular region, that is where the focus should be directed.

In the Northeast we could put on more farms tomorrow, if you did not have these price-support cuts, but you cannot make milk for 10 bucks.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. What are you getting for your milk?

Mr. STARR. Well, with the premiums and the incentives for protein, about $10.58, $10.60.

Senator BOSCHWITZ. Come on. How much are you——

Mrs. DUFFY. $11.60. That is the blend price.

Senator BOSCHWITZ. This is what you are getting at the farm gate, $11.50?

Mrs. DUFFY. Yes.

Senator BOSCHWITZ. And you?

Mr. STARR. I do not have——

The CHAIRMAN. Bob runs a trucking company in the Northeast.

Senator BOSCHWITZ. I see. Well, you know, if every State took the attitude that they are going to go on their own way, then perhaps you would not mind if you go on your own way, if we get rid of some of the national policy, for instance, some of the milk marketing orders.

I mean, if you are having trouble with your farmers in Vermont, I hope you have some understanding of the problems that we are having with our farmers in the Upper Midwest, where we are not getting $11.58 at the farm gate by any means, and where the percent of Grade A fluid usage is not as high. With all due respect to someone from Vermont, we do not want to put your farms out of business.

If you think that paying a temporary premium of 50 cents per hundredweight is not going to encourage production, that it is just going to maintain cash-flow, you ought to save your money. Do you mind if California has some of its own provisions, like a high make allowance? Is that OK, since you in Vermont want to have your own provisions?

Mr. STARR. Well, I do not really care about getting into a debate with you on what we should do and what we should not do, but I think any State should do what it can do.

Senator BOSCHWITZ. Fine. In that case we should remove, perhaps, some of the Federal protection that we give you. You cannot have both. And would you mind if we sent some reconstituted milk to the Northeast? Would that be all right?

The CHAIRMAN. I might note for the Senator from Minnesota that the milk orders will be the subject of our May 11 hearing.

Senator BOSCHWITZ. I understand, but if he wants to have his own little Vermont program, he can have it, but then he cannot be protected by the Federal price-support program which he says is inefficient, inequitable, and has undermined the family farm in Vermont.

Mr. STARR. Which it has done.

Senator BOSCHWITZ. I see. Tell me this. To change course here a little bit, there has been a suggestion that perhaps rather than looking at the supply side of the business, that we ought to look at the consumption side of the business.

I met with some people on the distribution end of the dairy industry recently, and one of them suggested that in the orders 1, 2, and 4, which would be New England, New York, New Jersey, and the Middle Atlantic States, that 35 cents a hundredweight assessment be imposed on the processors.

The 15 cent assessment on farmers would go down to 3 cents. The 3 cent assessment would be used for research, and then give back 12 cents of what is now assessed to the dairy farmers, and then have a 35 cent assessment on the processors and let them advertise.

They would try to increase usage so that we do not have to always stress the production end of this whole business.

What would be your thought on something like that? Have you thought about anything like that?

Mr. STARR. A little. And I do not know about the 35 cents or the 15 cents and the 3 cents. But I do know that what we are paying right now, which I believe is 15 cents, that even if you doubled that expenditure in promotion, that your sales are not going to go up accordingly with the extra money that you put into it.

Senator Boschwitz. Well, the processors suggest that they pay the 35 cents.

Mr. Starr. Well, it would make much more sense to me if a particular milk handler or processor advertised Kraft cheese, than we as a Nation just advertise cheese.

Because when we just advertise cheese, we are advertising the imported cheese; we are advertising all cheeses. And if the money was earmarked and headed toward wholesome American products, I think that might boost the sales.

I know in Vermont, if Cabot Farms, which is a co-op, if they run a particular ad advertising strictly Cabot products, their sales automatically go up. But if we just run a bunch of ads advertising cottage cheese and fresh dairy milk——

Senator Boschwitz. I would agree with that general approach. I would warn you that in my experience sales do not automatically go up.

Nevertheless, I do agree that advertising in a generic way has some disadvantages. I did not cover that in my question. And some of the milk handlers describe that as well.

The Chairman. I would note for the Senator, we have a rollcall vote on.

Senator Bond. If I might ask the Senator from Minnesota to yield, I have two suggestions. No. 1, in our proposal for international negotiations with respect to agricultural surpluses, and the administration has proposed to the European community that subsidies not be production-based.

In other words, if you want to give Vermont dairy farmers money to keep them in business, you make a flat payment that is not tied to production. Because I believe that if you want more of something, you subsidize it; if you want less of something, you tax it. I would suggest that.

And second, on behalf of the Senator from Minnesota, I would suggest—I do not necessarily agree with your regionalization concept; it is just how you draw the lines.

I had the pleasure of being educated in New England, briefly, and certainly, I always considered Boston a part of New England, but not New York. So if Senator Boschwitz and I can have New York, Chicago, Cleveland, Detroit, St. Louis, and the Twin Cities, we will give you Boston; is that OK?

Mr. Starr. Boston is our favorite southern city for Vermonters.

Senator Boschwitz. In summary, Mr. Chairman, I really feel that a State saying, "we want to go our own way," is poor policy and if every State should go their own way, we are going to have chaos.

The Chairman. That is what we are hearing.

Senator Boschwitz. That is what he says.

The Chairman. No, it is not. And I would note for the distinguished Senator from Minnesota, this is not the case. In fact, the testimony was very clear that until the Federal Government is able to put together a rational dairy policy that says we can have a dairy industry in all parts of the country that want to have a dairy industry, then some of those individual States are going to have to help out themselves, which is what Vermont is doing, a very small State with a very limited budget, but putting a large share of that budget in to keep farming viable in our State until a Federal policy can be put in place that makes it possible to have a dairy program there. That is what is being said; not a suggestion that each State go it alone, at least as I understand the testimony.

Senator BOSCHWITZ. I never argue with the distinguished chairman of this committee, but that is a prescription for total disaster, in my judgment, and chaos, if every State is going to do its own thing.

And of course, every State will not agree when a viable national policy is put into place.

The CHAIRMAN. The distinguished Senator has not pointed out the substantial amount of money that the Minnesota Legislature spends on farm programs in his State.

And with that final word, we will stand in recess while we go vote.

[Recess.]

Senator DASCHLE [presiding]. The hearing will come to order.

The Chairman will be here momentarily. As I understand it, Clyde Rutherford is our next witness. If he will come to the witness chair, we will take his testimony at this time.

Mr. Rutherford, we are delighted to have you. Chairman Leahy will be here momentarily. As you all know, there was a vote on the floor, so Members will be coming back to the committee room.

But we are glad you are here. We invite your testimony. And we will see that the entire text of your printed statement is inserted in the record, and we would invite you to proceed as you see fit.

STATEMENT OF CLYDE E. RUTHERFORD, CHAIRMAN, NATIONAL COMMISSION ON DAIRY POLICY, WASHINGTON, DC, ACCOMPANIED BY FRED DOUMA, VICE CHAIRMAN, ONTARIO, CA

Mr. RUTHERFORD. Thank you very much, sir. I appreciate this opportunity to present the views of the National Commission on Dairy Policy on future Federal dairy programs.

With me is our vice chairman, Fred Douma of Ontario, California. And with the permission of the committee, Fred will add a few observations at the conclusion of my remarks.

The National Commission on Dairy Policy formally unveiled its recommendations for a long term dairy program on March 31, as ordered in the legislation.

The details of our recommendations, along with the key points in our report, are spelled out in the statement which I have provided for the record. I will not repeat those details here, but a few points are in order.

All 18 of our members of the Commission endorsed our recommendations. Since they represented every dairy producing region of the Nation, and dairy enterprises of differing sizes and types, this was no small achievement.

I do believe many people either have not read the total report, or they are reading wrong interpretations into this report. The program we outline is long term; it is not a quick fix that gets the dairy industry through another year without a reduction in the support price.

It is a program that our members believe will serve the industry well into the 1990's and beyond.

Through a forward looking pricing formula, and standby production control authority, our program takes into account factors such as technological advancements that may substantially increase production in the coming years at a very rapid pace.

Our program is market oriented. It is designed to keep supply in line with demand; surpluses in check; and the cost of the dairy program under control.

Use of production controls is recommended only as a fail-safe in case market forces, together with support price adjustments, do not keep the market in balance. But that fail-safe may come in handy if technology or some other factor prompts projections of large surpluses.

Our report advocates creating an economic environment in which milk producers, regardless of the size of their enterprises, can earn a satisfactory return for their labors.

Nearly every person or organization, depending on which region they come from, has a definition of a family farm. But the fact is that over 98 percent of all the milk produced in this country comes from family farms of one description or another.

The policy recommended is a policy that makes profitability possible, but not guaranteed for producers nationwide. Those who are efficient, innovative, and industrious will prosper under this program.

Given the effort our members put in, some of the reaction to our recommendations leaves us somewhat confused. We were created by a Congress disturbed over mounting surpluses that escalated the cost of the dairy program.

Congress was likewise frustrated over the lack of unity in the dairy industry. Each member was nominated by a Member of the House or Senate with a stake in the dairy program's future.

We were told to come up with a set of recommendations the industry could endorse. We went to work and did just that. We recommended a program that has broad support among milk producers nationwide, and that support is growing.

Writing our report was no easy task. By definition our recommendations were a product of compromise. None of us likes everything in our report. Yet as a whole it is a package that each of us can support.

Certainly, from my own perspective, our recommendations will not solve all the problems of New York State producers, or the New England producers; nor will it solve all the problems of milk producers in California, Wisconsin, Minnesota, or any other State.

But each of us tried to look beyond parochial concerns in an effort to fulfill our congressional mandate. Having swallowed hard and accomplished what Congress asked, we would ask that more Members of the House and Senate do the same.

Having overlooked parochial concerns ourselves, we are concerned when we hear parochial concerns voiced by those who nominated us. Our members took their responsibilities very seriously. We realized this report was our industry's best opportunity to tell the Congress and the Secretary of Agriculture this was what dairy farmers want as policy.

We ask the House and Senate to consider our report with equal seriousness. Do not reject the entire plan based on objections to a single recommendation.

We are encouraged that some Members of Congress say they plan to use our recommendations as a blueprint for future dairy legislation. We understand well the need to move quickly. In less than 9 months, the 101st Congress will convene. Among its responsibilities will be writing new Federal dairy legislation.

Failure to act will see the milk support price revert automatically under the 1949 act to 75 percent parity—75 percent of the parity price of milk is approximately $17.40 a hundredweight. As a milk producer, I would like to get that much for my milk.

But I would prefer to receive it from the marketplace, and not from the Government.

We feel we have given you much to think about as you move toward drafting new dairy legislation by our report. Certainly we do not want to see our report suffer the fate of so many Commission reports, unveiled with much fanfare, only to be ignored by those who make policy.

As we see it, our Commission has provided a roadmap to a better program. It may not be an easy trip, but we hope Congress is not just interested in a Sunday ride, either.

Mr. Chairman, thank you for allowing me to testify, and with your permission, I would ask that the vice chairman have a chance to make a few additional comments.

[The prepared statement and a complete set of the recommendations, attached as an appendix, of Mr. Rutherford follow:]

Statement of
Clyde E. Rutherford
Chairman
National Commission on Dairy Policy
Before the
Committee on Agriculture, Nutrition, and Forestry
Of the United States Senate
Thursday, April 28, 1988

The report of the National Commission on Dairy Policy, submitted to Congress and the Secretary of Agriculture March 31, outlines a dairy policy for the future. It is a policy that members of the Commission -- all of them milk producers -- believe will serve the dairy industry well into the 1990s, and beyond. The Commission reached its conclusions after examining national policy issues in nearly every facet of dairy policy.

The report contains recommendations in policy areas ranging from technology to milk price supports. In the report, the material is organized into several sections, including: (1) general agricultural policy; (2) family dairy farms; (3) milk price support policy; (4) federal milk marketing orders; (5) regional issues; (6) advertising and promotion; (7) technology; (8) food safety and product identity standards; and, (9) trade and aid programs.

The Commission did not recommend change for the sake of change. Much of existing law, originating 40 years ago, can still operate well, with proper administration. In many cases, the report suggests needed changes in current law or administrative practices. Reviewing the present program was an explicit charge to the Commission.

Suggested changes include: amendments to laws; better administration of existing programs; closer coordination of ongoing efforts; more cooperation within the dairy industry; and a greater effort to achieve goals.

The specific recommendations must be read in context. Many months of study and deliberation were expended to achieve a system of related proposals -- some which might not be acceptable to milk producers without other accompanying changes recommended in the report.[1]

The report is endorsed by all 18 Commissioners. Considering that the Commissioners come from all parts of the United States, with various sized dairy operations, this complete endorsement is a remarkable accomplishment. The report is the first unified proposal for program changes from the dairy industry in more than a decade.

The report is far reaching -- it is not intended to be another short-term, quick fix to get the industry through another year. Instead, the Commission's report outlines major steps toward a revamped, long-term federal dairy program. The report is intended to be a blueprint for dairy policy in the future.

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[1] A complete set of the recommendations is included as an appendix to this statement.

As a result, it is unlikely that the recommendations will be enacted into law this year. Widespread industry understanding of the pproposals is needed first.

Sensible economic policy needed...

In establishing a context for the agricultural and dairy program recommendations, two questions were addressed: (1) What economic environment will promote the effective functioning of a market-oriented agriculture?; and, (2) What agricultural policy is consistent with sound dairy policy?

The report states that U.S. policy should foster an economic environment in which milk producers -- including those small-and-medium-sized operations that make up the majority of milk producers -- have the opportunity to receive a satisfactory return for their labor and investment. Those producers who are efficient, innovative, and industrious will prosper under the Commission's plan.

Goals of federal dairy programs, especially those attempting to control production, should not be thwarted by contradictory fforts to keep producers in business when economic reality dictates otherwise.

The federal government should not attempt to define the term "family farm" for the purpose of targeting or restricting farm program eligibility. Targeting benefits to a particular size or structure of farm is inefficient and undermines the basic purpose of the federal milk price support program.

Agricultural and dairy policy should create an economic environment that makes profitability possible -- but not guaranteed -- for the nation's milk producers.

Milk price support policy: A market-orientated approach...

The National Commission on Dairy Policy believes federal dairy policy should be market-oriented. Market forces, together with adjustments in the government support price, should balance supply and demand for milk and dairy products. While the Commission recommends the use of "standby" production controls, their use on a permanent basis is not in the best interest of the industry.

Continue supporting prices with purchases...

Supporting milk prices through government purchases of dairy products constitutes a workable basis for any dairy program.

The federal support price should establish a minimum price which guarantees an adequate supply of milk. The Food Security Act of 1985 established a means of modifying government price support levels. The Commission studied alternatives and believes a better method can be developed.

Consistent with the intent of the Agricultural Act of 1949, Commodity Credit Corporation purchases of dairy products must serve primarily to balance the domestic market annually. All other uses of surplus products, including maintaining a reserve for domestic and international food assistance programs, should be secondary.

Milk price supports should be set by a formula ...

The Commission concluded that market forces, together with adjustments in the government support price, should balance supply and demand for milk and dairy products. To determine the support price, an effective formula needs to be established in law. The formula must: (1) account for changes in technology in an explicit calculation; (2) take into account economic considerations in other agricultural segments; (3) be able to operate several years without major adjustments; and (4) have some latitude to account for shifts in supply or demand to prevent either a build-up of costly surpluses or decreases in production that result in shortages.

The Secretary of Agriculture should have discretionary authority to adjust the price indicated by the formula by 5 percent either upward or downward. However, in no case should the total price change -- formula adjustment plus any change dictated by the Secretary -- be more than 50 cents per hundredweight in any one year.

The Commission agreed to maintain the "action level" of 5 billion pounds of net Commodity Credit Corporation purchases. However, in the future, a specified percentage of commercial use should be adopted as the "action level." Since 5 billion pounds is 3 or 4 percent of commercial use today, then purchase volume should represent 3 or 4 percent of commercial use 10 years from now.

Production controls may be needed...

The use of a production control program on a permanent basis is not in the best interest of the dairy industry. Price adjustments should generally balance the market. However, if major price reductions were to be needed to balance supply and demand, then a production control program should be implemented in lieu of a major price reduction to reduce unneeded supplies of cheese, butter and nonfat dry milk.

The Commission believes the Secretary of Agriculture should have discretionary authority to impose controls when Commodity Credit Corporation purchases exceed the legislated "action level." If projected CCC stocks are to be 2.5 billion pounds above the "action level," the Secretary of Agriculture should be required to implement a production control program.

Temporary implementation of production controls to reduce the federal deficit is not consistent with the Commission's market-oriented philosophy. However, the Commission acknowledges that such a step may be necessary to meet deficit reduction targets.

Choices for the Secretary of Agriculture...

The Commission determined that the most effective production control programs are either a dairy termination program similar to that carried out in 1986-87, or a two-tier pricing program paying producers a price for milk used commercially and a lesser price for marketings in excess of that amount.

Factors such as: (1) the cost of the program; (2) the program's effect on other agricultural segments; (3) the economic conditions in agriculture; and, (4) fiscal goals; are all taken into account when a production control program is considered. The Commission determined that the Secretary of Agriculture should have options, since each program has desirable characteristics, to address these factors. Depending on circumstances, one program may be preferable.

The Commission provided the choice of programs to make it more difficult for producers to anticipate a specific type of production control program and thereby circumvent the program's intent. Allowing the alternative of a dairy termination program, for example, would make it less likely for producers to "race for base" in anticipation of the two-tier program.

Any costs associated with a production control program, to the extent that they exceed normal dairy program costs, should be borne by milk producers. However, producers can bear those costs in ways other than through assessments on milk production. A reduction in the milk support price may generate a reduction in government outlays sufficient to fund a production control program. Assessments are neither warranted nor necessary.

Federal milk marketing order program needs improvement...

The Commission believes significant improvements in the administration of the federal milk marketing order system are needed. Long delays in the hearing process have contributed to frustration among dairy producers -- frustration that led directly to provisions in the Food Security Act of 1985 which increased Class I milk differentials.

Marketing orders should be combined where economic efficiencies will result. However, timely amendment of market orders through the administrative process is preferable to changes made through legislation. The Commission asks USDA and the dairy industry to work together to speed up decision-making and make marketing orders more effective.

Regionalism...don't protect some producers

The Commission rejects a "regionalized" price support program.

Federal programs cannot and should not attempt to change basic geographical features favoring milk production in one area over another. These features, which include favorable climate, abundant feed, and a diverse agricultural base, will lead to increased production in certain areas over time.

Regionalizing dairy policy in an attempt to protect milk producers in any one area would counter these basic market forces. As a result, the Commission believes price support policy should not be modified regionally to protect producers in one area of the country.

Also in the area of regionalism, the Commission considered the appropriateness of California's separate manufacturing allowance for milk made into butter, cheese, and nonfat dry milk. It concluded the California allowance has interfered with the orderly working of the federal price support system by: (1) lowering the price received by California milk producers; (2) encouraging construction of additional California manufacturing plant capacity; and, (3) increasing federal purchases of dairy products from California plants.

The Commission believes USDA's specification of a manufacturing margin for milk should apply to all areas of the United States. Federal actions should prohibit California, or any other state, from establishing a separate allowance to promote the use of grade A milk to make butter, cheese, or nonfat dry milk.

The consumer must be informed...

In the area of advertising and promotion, the Commission endorses the current programs, financed through mandatory assessments on milk production. But it believes these programs must be monitored to determine their benefits to producers. Promotion should be cost effective, with changes in consumption serving as a guideline for spending on advertising in the future.

The Commission notes that the Dairy Production and Stabilization Act of 1983, which created the National Dairy Promotion and Research Board, refers to a "coordinated" promotion program. Consolidating functions of the Dairy Promotion Board and the United Dairy Industry Association would reduce administrative expenses, improve communication, and possibly save on program costs.

Technology...challenges and opportunities

The revolution in technology expected to hit the dairy industry in the next 10 years -- in areas including genetics, animal nutrition, disease control, and computers -- will increase efficiency, lead to increases in milk production, and could boost U.S. dairy product surpluses.

The dairy industry needs to plan for both the challenges and opportunities these changes will present. Likewise, the federal government should recognize and plan for technological advancements in determining future dairy policy.

The Commission does not believe new technologies should be prohibited from use based on their effect on either milk prices or industry structure. However, before technologies are marketed, federal authorities should determine their effects on: (1) wholesomeness of product; (2) consumer perception of products made with the technologies; and (3) the health of animals to which they are applied.

New technologies shown to be safe should move quickly to the farmer and dairy processor. They should be explained through media-oriented educational programs, with an adequately funded Agricultural Extension Service playing a major role.

Product identity and labeling...

The Commission also considered issues of dairy product labeling and standards of identity. It concluded that current standards of identity for agricultural products should be preserved. Additional efforts to preserve the identity of standardized dairy products should be funded in part by the dairy industry. Also, the Food and Drug Administration should place a higher priority on enforcement of standards of identity by providing more resources for monitoring the misbranding of foods, particularly new foods developed to simulate standardized products.

Uniformity in labeling likewise is essential to the efficient marketing and distribution of dairy products. The Commission concluded federal law should require application of the term "imitation" to any food product that simulates a standardized food in order to promote honesty and fair dealing in the interest of consumers.

International trade...challenges and opportunities

The United States has opened talks with member countries of the General Agreement on Tariffs and Trade on an agricultural trade reform proposal aimed at eliminating all export subsidies, tariffs, quotas, and domestic subsidies.

The Commission supports fair trade in international markets. It believes a free international trading environment is unachievable right now. However, it would welcome an economic analysis of the proposed zero-subsidy trading environment indicating what benefits -- if any -- U.S. dairy farmers would receive after one, five, or 10 years. Before the United States agrees to any modification to GATT as an outcome of the current negotiations, the advantages of any such agreement for the dairy industry must be shown.

The Commission strongly supports U.S. import quotas on dairy products authorized under Section 22 of the 1933 Agricultural Adjustment Act. It believes these provisions should not be negotiable in the current Uruguay Round of talks under GATT.

As a practical matter, without some means to limit dairy imports, the United States, with its high per capita income, would quickly become the dumping ground for subsidized world dairy surpluses. Milk price supports would become ineffective and costs would significantly increase as imports displaced domestic production -- production that would be purchased by the Commodity Credit Corporation under the price support program.

The Commission believes that casein imports interfere with the milk price support program and increase the outlays made under that program. Casein should be reclassified in the tariff schedule as a dairy product and thereby made subject to Section 22 quotas.

Look to the future ...

The report outlines a dairy policy for the future -- a policy that 18 milk producers believe will serve the industry well into the future.

In many cases, the report suggests needed changes -- either administrative or legislative. But the Commission did not advocate change simply for the sake of change. It has not put forward ill-advised recommendations simply to make headlines.

The report outlines the tools needed to make the dairy industry more profitable in the future. The Commissioners believe this report is the industry's best opportunity to tell Congress and the Secretary of Agriculture what dairy producers want as policy. The report can and should influence their future.

The Commission looks forward to the expeditious but thorough review of its recommendations and, ultimately, their implementation as the basis for the federal dairy program of the 1990s.

Appendix: Specific Recommendations of the National Commission on Dairy Policy

Family Dairy Farms

The Commission is recommending dairy policy that will create an economic environment in which the "family farm," by any definition, will survive. Distinctions based on size or other criteria were found to be unworkable and inappropriate for federal price support policy proposals or implementation.

> The federal government should not attempt to define the term "family farm" for the purpose of targeting or restricting farm program eligibility. Targeting benefits to a particular size or structure of farm is inefficient and undermines the basic purpose of the federal milk price support program.

Milk Price Support Policy: A Market-Orientated Approach

Market forces, together with adjustments in the government support price, should balance supply and demand for milk and dairy products. The use of production controls on a permanent basis is not in the best interest of the industry.

> A forward-looking formula should be established in law to determine the price support level for milk. The support price should provide enough milk to satisfy commercial demand and a market reserve. The formula should: (1) account for advances in technology that result in increased productivity; (2) account for economic conditions in both agricultural and nonagricultural segments; (3) be able to operate for a long period without revision; and, (4) account for shifts in the supply and demand for milk.
>
> The formula should include appropriate measures of milk production costs, consumer purchasing power, and the economic relationships between milk production and alternative agricultural enterprises.
>
> The formula should be revised and updated by law whenever the support price generated by it results in an unacceptable volume of Commodity Credit Corporation purchases in two consecutive years.
>
> The Secretary of Agriculture should have discretionary authority to adjust the milk support price indicated by the formula. However, in no case should the Secretary's adjustment exceed 5 percent of the price

indicated by the formula in any one year, nor should the total adjustment in the support price (formula adjustment plus Secretary's discretionary adjustment) be more than 50 cents per hundredweight annually.

The Commission recommends a system for standby production controls using the following guidelines:

Provisions of the Food Security Act of 1985 that established the 5 billion pound purchase level to signal adjustments to the milk support price program should be maintained. However, such level should be based on an equivalent percentage of commercial use in the future. If CCC purchases are projected to be in excess of the amount which signals price adjustments, the Secretary of Agriculture should have specific discretionary authority to carry out a production control program.

When CCC purchases of dairy products are projected to exceed by 2.5 billion pounds the amount at which a change to the price support program is indicated, the Secretary of Agriculture, after making the maximum allowable adjustment in the support price, should be required to implement one of two production control programs:

A dairy termination program operating under the general guidelines authorized in the Food Security Act of 1985, or

A "two-tier" pricing program paying producers a price for a set percentage of milk marketings and a lesser price for marketings in excess of that amount. To fund additional CCC purchases of dairy products, the Secretary of Agriculture shall establish a charge for marketings above the full-price at a level that is at least 50 percent of the support price.

If a dairy termination program is implemented, the Secretary of Agriculture should:

Accept bids in each state at levels assuring that a uniform percentage of production capacity is reduced in each state.

Minimize adverse effects on the beef cattle industry.

Prohibit participants from re-investing in the milk production industry in ways that circumvent the program's intent.

If a two-tier pricing program is implemented:

An individual's marketing history, at the producer's option should be either the most recent 12 month production period, or, the prior 12 month production period.

Marketing bases should be transferable to anyone during the program and are unneeded when the program is not in effect.

Adverse effects on the beef cattle industry should be minimized.

Production controls should terminate when CCC purchases of dairy products are projected to be less than the legally established amount at which a change to the price support program is indicated.

Costs associated with a production control program, to the extent that such costs exceed normal dairy program costs, should be borne by milk producers. However, producers can bear those costs in ways other than payment of assessments. A reduction in the milk support price may generate a reduction in government outlays sufficient to fund a production control program. Assessments are neither warranted or necessary.

With the expiration of the Food Security Act of 1985, adjustments to the milk support price should be made on October 1.

Federal Milk Marketing Orders

The Commission believes significant improvements in the administration of the federal milk marketing order system are needed.

The Secretary of Agriculture should take all necessary actions to reduce the time between a legitimate hearing request and announcement of a decision to grant or deny a hearing. Further, the Secretary, as quickly as possible in light of legal requirements and consistent with good management practices, should render a recommended decision within 90 days after the close of a hearing.

Exceptions to the 90-day rule should be granted only by an administrative law judge for hearings that involve extensive or conflicting testimony, multiple or new issues, or innovative practices.

The Secretary of Agriculture should grant a hearing when requested by: (1) a majority of the milk producers supplying the federal milk marketing order; or, (2) the dairy cooperatives and proprietary handlers in a federal order, provided that they market more than 50 percent of milk in the order.

Marketwide service payments should be granted in an order where the request is substantiated.

The continued existence of a federal order should not be jeopardized by the vote on a single amendment to the order. The Secretary of Agriculture should modify current administrative procedure to allow votes on individual amendments to a federal order.

Federal orders should be allowed to consolidate through the normal hearing process when economic efficiencies can be achieved. However, legislation should not create a single national milk marketing order.

By the end of 1988, the Secretary of Agriculture should establish an adequate standard testing procedure to allow the implementation of multi-component pricing throughout the federal milk marketing order system.

A system of testing packaged fluid milk products for compliance with federally approved standards should occur under the federal milk marketing order system.

Regional Issues

Federal milk price support policy should not be modified to protect producers in any area of the country.

Dairy policy should assure that supplies of fluid milk come from a diverse geographic area to guarantee an adequate supply.

USDA's specification of a manufacturing margin for milk made into cheese, butter, or nonfat dry milk should apply to all areas of the United States. Federal law should prohibit California or any other state from using a greater allowance to establish a grade A price for milk used for manufacturing butter, nonfat dry milk, and cheese.

Advertising and Promotion

Advertising and promotion boost consumption of dairy products, helping both the farmer and the taxpayer. However, advertising and promotion programs should be monitored to determine their benefits to producers. Promotion should be cost effective, with changes in consumption serving as a guideline for spending on advertising by the early 1990s.

> The functions of the National Dairy Promotion and Research Board and the United Dairy Industry Association should be consolidated in 1988 to avoid costly duplication of effort. It is expected that this consolidation would not affect the National Dairy Council's status as a separate, non-profit nutrition education and research organization.
>
> Mandatory participation by all milk producers in the national promotion program, with a promotion check-off, should continue.
>
> No increase in the promotion assessment should be approved unless strong evidence verifies the cost effectiveness of the proposed change. This effectiveness should be demonstrated through a study to determine the benefits and the cost of the change.
>
> USDA should assist in determining cost effectiveness by providing nationwide information on changes in supply or demand for dairy products. This data should take into account consumption patterns, income levels, demographic patterns, and price responsiveness.
>
> Federal competitive grants should be authorized specifically for research leading to the development of new dairy products that would increase the dairy industry's efficiency, productivity, and ability to compete internationally.

Technology

The dairy industry should plan for both the challenges and opportunities these changes present. Likewise, the federal government should recognize, plan for, and accommodate technological advancements in determining future dairy policy.

> New technologies should be explained through media-oriented educational programs. The Agricultural Extension Service, with adequate funding from Congress, should play a major role in this effort. The education

of dairy farmers concerning technological advances, especially in production techniques, should have a high priority. The consumer represents a separate but important audience for such educational programs.

Food Safety and Product Identity Standards

Maintaining and marketing of safe, high quality, nutritious, and identifiable milk and dairy products is of prime importance to the dairy industry.

> The Food and Drug Administration should specify allowable levels for residues that are detectable by scientific valid testing procedures based upon a significant relationship to public health. Major emphasis is needed to develop practical and sensitive on-farm procedures capable of screening agriculture products to measure allowable levels.
>
> Currently FDA has neither the resources nor a high priority program for enforcement of economic standards which prevent fraud and deception in the marketplace. Greater emphasis is needed in two specific areas: (1) enforcement of existing standards of identity to protect the consumer from fraud and deception; and, (2) enforcement of misbranding provisions of the Food, Drug and Cosmetic Act, particularly with regard to non-standardized foods which purport to resemble foods for which standards of identity or common or usual names have been established. If properly carried out by FDA, such efforts should prevent fraud and deception in the marketplace and should, therefore, be funded in part by the taxpayer. Present standards of identity for traditional agriculture products should be maintained. Efforts that serve to preserve the identity of standardized dairy products should be funded in part by the dairy industry. The Food and Drug Administration should place a higher priority on enforcement of standards of identity by providing greater resources for monitoring the misbranding of all foods, particularly new foods developed to simulate standardized products.
>
> Individual state laws and regulations, such as California's Proposition 65, that supersede federal food safety standards for toxic chemicals and carcinogens should be prohibited. In situations where no federal standards exist, they should be established.
>
> Uniformity in product standards and labeling remain essential to the promotion of efficient production,

marketing, and distribution of food moving in interstate commerce. Federal law should require the term "imitation" to be applied to any food product that simulates a standardized food in order to promote honesty and fair dealing in the interest of consumers. Congress should define the term "imitation" to clarify existing FDA regulations which base imitation solely on the criteria of nutritional inferiority, contrary to the intent of Section 403 of the Food, Drug and Cosmetic Act.

FDA should withdraw its health claim labeling proposal of August 4, 1987.

Trade and Aid Programs -- Effects on the Dairy Industry

The Commission urges the dairy industry to explore and develop additional market opportunities overseas, making particular use of long-term marketing and consumer education plans. Efforts to boost exports for market development should concentrate on low-income nations where markets do not now exist. The Commission recommends that improvements be made to the trade negotiation process currently being used.

Import quotas on dairy products authorized under Section 22 of the 1933 Agricultural Adjustment Act should be maintained and enforced as long as "free international trade" does not exist. They should not be eliminated or increased during negotiations of the General Agreement on Tariffs and Trade.

Because the current volume of casein imports interferes with the milk price support program, the volume of casein imports should be reduced and casein should be reclassified as a dairy product and subjected to Section 22 import quotas.

There should be public and private funding of studies to ascertain which countries represent a potential market for U.S. dairy products and which countries are potentially self-sufficient in production of milk and dairy products.

USDA should maintain dairy product distribution programs that encourage the increased use of dairy products.

USDA should require an annual minimum quantity of domestic dairy products to be used in Food for Peace programs.

USDA should encourage the development of international markets for dairy products and dairy cattle by assisting industry-initiated activities through use of the Dairy Export Incentive Program, or by greater use of the Export Enhancement Program. Dairy products must be made available for such efforts for an extended period of time. Where dairy products can be used in overseas donation programs that could lead to new markets, such use should be greatly expanded.

The **Chairman**. I have no objection. I just note that we have another rollcall vote on the Kennedy amendment which is now in progress. It is a 15-minute rollcall vote, and the vote began at 10:36.

We will stand in recess again, and go and vote. And I would urge everyone to come back as quickly as they can to start up again. And then, yes, of course, you can have a chance.

[Recess.]

Senator **Melcher** [presiding]. The committee will come to order.

As I understand it, Mr. Douma, you had some remarks. Mr. Douma.

Mr. **Douma**. Mr. Chairman, my remarks will be on a few areas of the Commission's report to afford a little more detail and background on how the Commission came to those findings.

In the Commission's process of determining whether there should be one national support price program, through the investigation and study of regionalizing the milk price support program, the Commission found that in fact there existed in California a form of regionalization already.

Our recommendation is to prohibit that action by specific Federal law.

California has established for its State marketing order a manufacturing allowance for processors to process milk into butter, nonfat dry milk and cheese, an allowance set at approximately 60 cents per hundredweight higher than that used in the Federal program.

This has negatively affected the price received by California producers, and as intended by the administrators of the State program, has encouraged construction of excessive California manufacturing plant capacity, even when prices for these products were at support.

Now, the Commission is not against the free enterprise or the demands of the marketplace creating the ability to increase plant capacity.

What the Commission is saying, that a State program should not, through a different program, when the national program is trying to reduce product, encourage increased production of those products.

The increased manufacturing capacity in California since 1982 by both cooperatives and proprietary concerns is directly related to this State administered pricing function.

This action interferes with the Federal price support program, and increases Federal purchases of dairy products from California plants as well as from other areas of the Nation, as California product begins to displace historical marketing patterns.

The Commission concluded that U.S. milk producers should be treated equally under Federal laws that compel a government agency to purchase dairy products under the price support program.

Substituting the Federal Minnesota-Wisconsin price series as a minimum California price for Grade A milk used for manufacturing purposes will increase prices for California producers to the same minimum level as the Class III, or in some cases, Class II prices, in all Federal milk marketing orders.

Processors of dairy products nationwide should have equal raw product costs when producer prices are supported through the purchase of products from those processors.

The Commission recommended that USDA's specification of the manufacturing margin for milk, should apply to all areas of the United States. Federal law should prohibit California or any other State from using a greater allowance to establish a Grade A price for milk for manufacturing cheese, butter, and nonfat dry milk.

And as a California dairy farmer, in my discussions with our own State administrators, they complained that the Commission had no right to look at the State marketing order. My answer to them was that the State of California missed one point, when they determined that a processing margin should be used to increase capacity to handle all the milk that California dairymen desire to produce, they did not go that last step to create a system that bought the products from those processors that did not find a commercial need.

They left that up to the Federal Government. And therefore, the Commission believes that it definitely is in the interests of the Commission and in the interests of Congress to look at that program in California.

A couple of comments on the international competitiveness of this Nation. The Commission believes the dairy industry can do more to develop market opportunities overseas, making particular use of the long term marketing and consumer education plans.

Research should continue to develop products for foreign diets and in lower income nations. Some past foreign policy decisions have been extremely disruptive to agriculture trade. Federal policymakers should take into account the effects of policies that hinder trade competitiveness when formulating trade policy.

Internationally such policies include monetary policies and import restrictions. Domestically, they include strict health and environmental standards that increase cost and decrease opportunities for export sales.

The Commission recommended that USDA encourage the development of international markets for dairy products through the use of the Dairy Export Incentive Program, and greater use of the Export Enhancement Program.

This may conflict with the U.S. GATT proposal, but could be a means to show our resolve toward free and fair trade.

To encourage export sales of dairy products, the Commission recommended that under any production control program, there be compensation for penalties assessed on overbase production sold for export use.

In administrative procedures, the Commission believes significant improvements are needed in the administration of the Federal milk marketing order system. Specifically, it recommended that the Secretary of Agriculture take steps to reduce the time between a legitimate hearing request and an announcement of a decision to grant or deny a hearing.

Also as quickly as possible in light of legal requirements and good management, the Secretary should render a recommended decision after the close of the hearing in a timely manner.

The Commission concluded the function of the National Dairy Promotion and Research Board, the United Dairy Industry Association, should be consolidated in 1988 to avoid costly duplication of effort.

However, it expects this consolidation would not, and should not, affect the National Dairy Council status as a separate nonprofit nutrition and research organization.

With that I have finished my remarks. Thank you.

Senator MELCHER. Thank you.

Mr. RUTHERFORD. Mr. Chairman, if I could, there are three other Commission members I would like to recognize: Bob Foster from the State of Vermont; Tom Camerlo from the State of Colorado; and Irv Elkin from the State of Wisconsin.

Senator MELCHER. Thank you. Senator Boschwitz, do you have some questions?

Senator BOSCHWITZ. Well, sure, I do. As the chairman knows, I think that the Commission's report was a good one. As I said at the time, if you can get 18 farmers to agree, that is quite an accomplishment, and from all sectors from the country.

That is why I was particularly stung when the first Member of Congress out of the box said, yes, his State has to go it on its own, though. If we are going to have that, we are just going to have problems.

We will be happy to go it on our own in our State if we did not have some of the restrictions that exist in present legislation.

I very much agree with your statement early on that you were concerned about some of the parochial concerns of those who nominated you; that was a nice way of putting it, as a matter of fact.

I was stung at that time that, gee, I just received the report on that day, and I had not read it. I had read the summary and I thought that there was a lot of food for thought there. I was certainly sorry that some of my colleagues felt they had to reject the report almost out of hand.

I felt that that was not quite the approach I would have wanted to take myself. I also want to assure you that your report will receive consideration.

I have it in mind, and probably will introduce it as a piece of legislation, the entire report, and I will see how that can be done, because certain parts of it argue both sides of the case.

But I will see to it that your report, which I think is a very valuable one, is indeed considered by the Congress as a whole.

You know, reports are just what you say. I was over talking to the Secretary of Defense the other day. He told me that the Defense Department has to provide the Congress each year with 715 reports.

I am not sure that I have ever read any of them. I probably have read one or two. A fraction of 1 percent of them, and I am not sure that any of them are ever really seriously considered.

I am sure that 100 of them are very significant, and that 600 of them probably are not.

One of the reasons that I voted against this new trade bill is that it not only establishes three dozen new commissions, agencies, and other groups, but it requires about—we cannot quite tell—somewhere between 150 and 165 new reports.

That is a lot of paper that is going to go flowing around here, and probably not amount to much at all.

So it is my intention to introduce your report as a piece of legislation. And as I mentioned, I do not agree with every aspect of it, particularly some of the international trade things which were just referred to in the testimony.

I think that American farmers, dairy farmers included, will compete very well in an international regime where there is a level playing field.

I am not sure that our people are the most competitive, but they certainly are more competitive than most. So I think that we will fare quite well.

I think that I will also introduce a further piece of legislation dealing with market orders, and it may be joined with the piece of legislation about your report, or it may be a separate piece of legislation, inasmuch as you did not deal with market orders extensively in your report.

But that certainly is one of the important elements of dairy in the future.

As you point out dairy is going to undergo very many changes because of increases in productivity. In 1959 there were, to be quite exact, 1,986,000 dairy farmers in this country. Now there are less than 300,000. It is a decrease of 85 percent.

Perhaps some of our friends from some of these States decry that decrease. I suppose it would be nicer if you had a couple of million guys squeezing away out there. But it is not in the cards. On came this machinery, and that really caused a decline in the numbers. And now we are going to have these super cows, perhaps, and that may cause a further decline.

And one of the things that you did deal with, but not extensively in your report, was increase in consumption. I think that so much of our time and effort and energy is directed at the production end, and not very much at the consumption end.

You may have heard me say a little earlier that I addressed the National Independent Dairy Council. They are people pretty much in the business of Grade A.

One of them talked about the idea of changing the market orders in your area, as a matter of fact, the first, second and fourth, which is New England, New York-New Jersey and the Middle Atlantic, and taking away 12 of the 15 cents now assessed, and putting in an assessment on the handlers, 35 cents, and letting them do the advertising.

What would you think of that approach? How can consumption be spurred in this whole business? We have had some increases in consumption in recent years, but there have been overall great declines from 730 pounds per annum down to about 530, and now it has picked up a little bit. I am not quite sure where it is; I suppose it is pushing 600. But if it could go up to 650, that could solve a lot of our problems.

Did your Commission consider at all the business of increasing consumption?

Mr. **Rutherford**. We had a number of studies which were presented to the Commission relative to the, number one, the effectiveness of the present promotion program.

Also, the effect of future commercial sales as to what do more dollars mean to increasing sales. And it was clearly shown that there is a limit; that perhaps the economic side tends to change sales much faster than promotion programs.

Senator BOSCHWITZ. What does that mean, the economics of it?

Mr. RUTHERFORD. That the price the consumer pays will generally affect, or the state of the economy, that if the economy is flourishing, and people have the money, they tend to be purchasing more dairy type products.

We did review it, and we did agree that there is a national promotion board that is structured. We do think that they need to work out their problems in the whole advertising arena.

But that is an effective program, given what they have to work with.

Relative to the proposal that you referred to in the Northeast, Federal orders 1, 2, and 4, as I understand it, that is again, basically, just a Class I promotion program.

Senator BOSCHWITZ. That is correct.

Mr. RUTHERFORD. I think nearly all studies show that that is not the area of growth in dairy sales; that the manufacturing side, either through the present products or through research and development——

Senator BOSCHWITZ. But in the event that the handlers pay it, as a matter of fact, reduce the amount that would be deducted from your check?

Mr. RUTHERFORD. Well, my understanding—and again, I am not fully familiar with that proposal—but my understanding is that the money would come out of the pool, the price pool. So in effect it does come out of the producer, that if the price of Class I milk was $14, it would be minus 36 cents.

Senator BOSCHWITZ. Not the way it was described to me.

Mr. RUTHERFORD. I am not fully familiar with it, but that was my understanding of the initial proposal.

Senator BOSCHWITZ. One of the only things I agreed on with the preceding witness was that if you advertise generically, it cannot be hard-hitting enough, particularly if you get 36 farmers and put them on the board. You are not going to get very hard-hitting type of advertising.

But other than that particular approach or suggestion, your group felt that promotion, trying to increase consumption, is not the answer; that you had reached a certain level?

Mr. RUTHERFORD. The studies we receive show that for return on investment, we have really pretty much met our maximum in the advertising area.

Now, I think, carrying that one step further, I know that there are discussions amongst the industry, the farm side and processing side, to look at some ideas which could help generate and combine the generic brand advertising programs.

And while that was not a Commission decision, my feeling is that that concept has strong support. But relative to generic advertising, the report that was made to the Commission showed that we probably are at a level of return on investment.

Senator **Boschwitz**. Well, I would hope that there would be some people in the industry who are a little more daring than whoever wrote that report.

I watch the advertising of your industry, and as I see the upward trend of consumption of competing products, and see the downward trends that have been associated with dairy, and where it was, and where it is.

It used to be that consumption was a good deal higher; and there may be a good deal of room for improvement and growth there.

I think that we need to get away from just trying to figure out how to balance out, handle, regulate, support, penalize, or whatever else, the production end; and put more attention on the marketing of the product.

I like your report. I think it is well balanced. I will really look at it in depth, and I will introduce it as legislation. And I compliment you and your Commission.

Where are you from in New York State, incidentally?

Mr. **Rutherford**. Central part of New York State.

Senator **Boschwitz**. And how many cows in your herd?

Mr. **Rutherford**. We milk 80 cows.

Senator **Boschwitz**. I know that some of the criticism of your group was that you were just interested in these dairy factories, whatever they are called. And I know that the dairyman from Minnesota had three dozen cows or so.

Your Commission was pretty well mixed in that regard, wasn't it?

Mr. **Rutherford**. Our Commission covered all aspects, from a young dairyman, Jim Holte, from Wisconsin, who is in his very early 30's, trying to establish himself as a dairyman, covering all organizations, dairy co-ops, farm organizations, independent producers; all sizes and ages.

Senator **Boschwitz**. Tell us just a little bit more for the purpose of the record the sizes of farms that were involved in the Commission.

Mr. **Rutherford**. Well, as I said, it would range from Jim Holte, who is a young dairyman of about 40 milk cows, I believe is what he had, to Pearson Knolle, who lives in Corpus Christi, Texas, whose family milks about 2,200; I believe that is the broadest range.

Senator **Boschwitz**. How many of the Commission members had, let us say, 100 cows or less?

Mr. **Rutherford**. More than half, I would say. Going the other way, those that were over 100, I would say probably 40 percent had 100-plus.

Senator **Boschwitz**. So that this was truly a group of family farmers?

Mr. **Rutherford**. They were all family farmers.

Senator **Boschwitz**. Even though the fellow with 2,200, even though my people would not consider it a family farm.

Mr. **Rutherford**. The Knolle family operates that as a family operation.

Senator **Boschwitz**. I understand. I had 68 warehouse stores. I also operated that as a family operation.

Well, I thank you all very much. And again, I think that you have done a great service, and I will try to see that that service does not fall on deaf ears; that it is considered thoroughly.

Mr. **Rutherford**. We appreciate that. And myself, and I know other members who served on the Commission, would make themselves available to discuss the text, the meaning and the intent of the report with anyone to clarify in any areas that they have a problem with.

Senator **Boschwitz**. Well, you also have a very good chief of staff who I know quite well who served on this committee for some time. So I will talk to him as well.

Senator **Melcher**. Thank you very much, Mr. Rutherford and Mr. Douma.

Our next panel is composed of Dr. Andrew Novakovic from Cornell; Dr. Jesse from the University of Wisconsin; and Dr. Butler from the University of California at Davis.

Senator **Boschwitz**. Mr Chairman, I have something going at 11:30 which will keep me probably for half an hour, after which I will try to return.

But may I ask that Dr. Jesse be the first witness?

Senator **Melcher**. Would you like to ask Dr. Jesse something right now?

Senator **Boschwitz**. No, I want to hear his testimony. I could read it, I suppose.

Senator **Melcher**. Dr. Jesse, could we hear from you first?

STATEMENT OF EDWARD V. JESSE, PROFESSOR OF AGRICULTURAL ECONOMICS AND AN EXTENSION DAIRY MARKETING AND POLICY SPECIALIST, UNIVERSITY OF WISCONSIN, MADISON, WI

Dr. **Jesse**. Certainly. My name is Edward V. Jesse. I am a professor of agricultural economics and an extension dairy marketing and policy specialist at the University of Wisconsin. I want to thank the committee for allowing me this opportunity to discuss the report and recommendations of the National Commission on Dairy Policy.

I will comment on the National Commission report from the perspective of the Upper Midwest. While I make no claim to speak for all dairy interests in that region, I believe that my views are widely shared by dairy farmers in Wisconsin and Minnesota.

The National Commission on Dairy Policy is to be commended for an extensive review and assessment of major issues facing the dairy industry. The Commission report contains a detailed listing and evaluation of policy options. It will be widely read and widely debated.

Especially commendable is the Commission's recognition of regional distortions in milk marketing, and its specification of corrective measures. The Commission notes the importance of coordinating feed grain and dairy policies, so as not to penalize regions of the country like the Upper Midwest, where dairy farmers typically produce their own feed. The Commission clearly spells out how higher manufacturing allowances in California distort cheese markets, and recommends adoption of uniform allowances nationally.

It notes how subsidized casein imports distort domestic dairy markets and enlarge the magnitude of CCC dairy purchases, and it persuasively argues for import restraints on casein, as well as the retention of current section 22 quotas.

However, while condemning market distortions in general, the report and its recommendations do not address the fundamental source of distortion in the dairy industry—Federal order Class I pricing.

The report stresses the need for a flexible, market oriented dairy policy. Yet the report is silent on the issue of how inflexible Federal order pricing, which is unresponsive to local milk supply and demand conditions, has artificially stimulated milk production in some regions of the country at the expense of other regions. Recommendations relating to orders call only for streamlining the order hearing process. Absent are recommendations that move toward eliminating order pricing distortions.

The Commission appropriately rejects regionalization of the Dairy Price Support Program. It specifically recommends that (p. 80), "Federal milk price support policy should not be modified to protect producers in any area of the country." At the same time, the Commission seems to condone the continuation of a Class I pricing system that bears little relationship to costs of production or fluid milk demand. Producers in some areas of the country are clearly being protected by the Federal order system. It is inconsistent to suggest that differential regional treatment is wrong under price supports, but acceptable under Federal orders. The report notes that (p. 8),"The milk price support program should treat all producers equally." We in the Upper Midwest think that so should the Federal order system.

An example of regional pricing distortion under Federal orders is appropriate at this time. In 1986, USDA estimated milk production costs in Texas to be 50 cents per hundredweight less than in the Upper Midwest. Yet the minimum order blend price in Texas averaged $1.50 per hundredweight higher than in the Upper Midwest. These differences suggest that it was $2 per hundredweight more profitable to produce milk in Texas than in the Upper Midwest.

In spite of this difference in profitability, or implied profitability, the Food Security Act of 1985 increased Class I differentials in Texas by 96 cents per hundredweight. Class I differentials in the Chicago and the Upper Midwest orders were increased by 14 and 8 cents, respectively. The difference in order minimum blend prices between Texas and Chicago increased by 60 cents per hundredweight overnight.

Was this increase needed to assure an adequate supply of fluid milk in Texas? Texas dairy farmers contracted 637 million pounds of 1985 milk production (16 percent) in the Dairy Termination Program. Between 1985 and 1987, producers under the Texas order increased milk deliveries by 250 million pounds. Fluid use declined at the same time by 90 million pounds. In other words, 340 million pounds of unneeded milk were added to the U.S. manufacturing milk supply because order prices were, and are, far in excess of what is necessary to assure an adequate fluid supply.

I am not here to bash Texas; this example is only illustrative. The point is that the process of setting minimum Class I differentials mechanically on the basis of distance from the Upper Midwest ignores changes in relative profitability. If minimum blend prices are too low to encourage enough production to meet local fluid needs, competitive forces can and will elevate prices above the minimum level. But if minimum blend prices are too high and induce surplus production in some markets, there is no way to adjust them downward to correct the situation.

To balance national milk supply and demand, the Commission proposes continued cuts in the support price, combined with authority to implement standby temporary supply control. This might be a fine approach if all dairy producers were being treated equally; in fact, they are not. Some dairy farmers enjoy fictitiously high milk prices as a result of Federal order distortions. Cutting prices while retaining these distortions would severely penalize dairy farmers in the Upper Midwest. Supply controls, however implemented, would serve only to lock in place distorted production patterns.

I see the red light, so I will finish up rapidly here.

I would say that the term, level playing field, is exactly what Upper Midwest dairy farmers are seeking in relation to Federal dairy programs. They are willing and able to effectively compete in milk production and marketing, as long as the environment is fair and competitive. If dairy farmers in other regions of the country can produce milk at a lower cost, so be it—as long as prices in other regions are competitively determined. We strongly oppose an inflexible administered pricing system that ignores market realities by setting prices fictitiously high in some regions at our expense.

I thank you for this opportunity to express my views.

[The prepared statement of Dr. Jesse follows:]

STATEMENT OF EDWARD V. JESSE, PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF WISCONSIN-MADISON

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Especially commendable is the Commission's recognition of regional distortions in milk marketing and its specification of corrective measures. The Commission notes the importance of coordinating feed grain and dairy policies so as not to penalize regions of the country like the Upper Midwest where dairy farmers typically produce their own feed. The Commission clearly spells out how higher manufacturing allowances in California distort cheese markets, and recommends adoption of uniform allowances nationally. It notes how subsidized casein imports distort domestic dairy markets and enlarge the magnitude of CCC dairy purchases, and it persuasively argues for import restraints on casein as well as the retention of current Section 22 quotas.

However, while condemning market distortions in general, the report and its recommendations do not address the fundamental source of distortion in the dairy industry --Federal order Class I pricing.

The report stresses the need for a flexible, market-oriented dairy policy. Yet the report is silent on the issue of how inflexible Federal order pricing, which is unresponsive to local milk supply and demand conditions, has artificially stimulated milk production in some regions of the country at the expense of other regions. Recommendations relating to orders call only for streamlining the order hearing process. Absent are recommendations that move toward eliminating order pricing distortions.

The Commission appropriately rejects regionalization of the dairy price support program. It specifically recommends that (p. 80), "Federal milk price support policy should not be modified to protect producers in any area of the country." At the same time, the Commission seems to condone the continuation of a Class I pricing system that bears little relationship to costs of production or fluid milk demand. Producers in some areas of the country are clearly being protected by the Federal order system. It is inconsistent to suggest that differential regional treatment is wrong under price supports; acceptable under Federal orders. The Report notes that (p. 8), "The milk price support program should treat all producers equally." So should the Federal order system.

An example of regional pricing distortion under Federal orders is appropriate: In 1986, USDA estimated milk production costs in Texas to be 50 cents per hundredweight less than in the Upper Midwest. Yet the minimum order blend price in Texas averaged $1.50 per hundredweight higher than in the Upper Midwest. These differences suggest it was $2.00 per hundredweight more profitable to produce milk in Texas than in the Upper Midwest.

In spite of this difference in profitability, the 1985 Food Security Act increased Class I differentials in Texas by 96 cents per hundredweight. Class I differentials in the Chicago and Upper Midwest orders were increased 14 and 8 cents, respectively. The difference in order minimum blend prices between Texas and Chicago increased by 60 cents per hundredweight overnight.

Was this increase needed to assure an adequate supply of fluid milk in Texas? Texas dairy farmers contracted 637 million pounds of 1985 milk production (16 percent) in the Dairy Termination Program. Between 1985 and 1987, producers under the Texas order increased milk deliveries by 250 million pounds. Fluid use declined by 90 million pounds. In other words, 340 million pounds of unneeded milk were added to the U.S. manufacturing milk supply because order prices are far in excess of what is necessary to assure an adequate fluid supply.

This example is only illustrative. The point is that the process of setting minimum Class I differentials mechanically on the basis of distance from the Upper Midwest ignores changes in relative profitability. If minimum blend prices are too low to encourage enough production to meet local fluid needs, competitive forces can and will elevate prices above the minimum level. But if minimum blend prices are too high and induce surplus production in some markets, there is no way to adjust them downward to correct the situation.

To balance national milk supply and demand, the Commission proposes continued cuts in the support price combined with authority to implement standby temporary supply control. This might be a fine approach if all dairy producers were being treated equally. They are not. Some enjoy fictitiously high milk prices as a result of Federal order distortions. Cutting prices while retaining these distortions would severely penalize dairy farmers in the Upper Midwest. Supply controls, however implemented, would serve only to lock in place distorted production patterns.

There are other parts of the National Commission Report that Upper Midwest dairy farmers find curious, inconsistent, and troublesome. Much space is devoted to rejecting regionalism; to laudatory references to market orientation and efficiency; to letting dairy farmers compete on the basis of relative costs of production. The Report notes that, "There is no nationally dominant area that produces manufactured milk products..." (p. 86) and that forced self sufficiency would "...adversely (a)effect industry efficiency." At the same time, the Report states that (p. 85), ". .federal policy should encourage maintaining a regionally dispersed milk production capability to supply fluid markets through use of federal milk marketing orders." Given current technology in dairy processing, it is hard to understand why manufactured dairy product markets are national, but fluid markets are regionally sacrosanct.

The Commission struggled to define a family farm, and ultimately concluded that a definition was inappropriate for policy purposes. Moreover, it states that (p. 29), "Targeting benefits to a particular size or structure of farm is inefficient and undermines the basic purpose of the federal milk price support program." This recommendation seems a bit curious in light of nearly 30 years of payment limitations under Federal commodity programs that use direct payments. In 1970, Congress clearly stated its intent to differentially benefit smaller grain, cotton, and rice farmers. Why are milk producers different from corn producers?

The Commission soundly rejects use of the Federal dairy price support program to achieve social goals. The mere existence of a dairy price support program reflects a social goal; one of assuring stability and adequate returns to dairy farmers. What is different about distinguishing within the class of beneficiaries?

The term, "level playing field," is overused. Nonetheless, that is exactly what Upper Midwest dairy farmers seek in relation to Federal dairy programs. They are willing and able to effectively compete in milk production and marketing as long as the environment is fair and competitive. If dairy farmers in other regions of the country can produce milk at a lower cost, so be it -- as long as prices in other regions are competitively-determined. We strongly oppose an inflexible administered pricing system that ignores market realities by setting prices fictitiously high in some regions at our expense.

Thank you for this opportunity to express my views.

Senator **Melcher**. Dr. Novakovic.

STATEMENT OF ANDREW M. NOVAKOVIC, ASSOCIATE PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, CORNELL UNIVERSITY, ITHACA, NY

Dr. **Novakovic**. I am sorry, my prepared paper is lying on my desk at home due to my error. I would like to extemporize a bit in my testimony.

The reaction to the report that the Commission has delivered I think has in many ways been shaped by its recommendations relative to the price support program, which I think primarily is today's focus.

I knew Dr. Jesse was going to bring up Federal orders, and I want to comment on those, too, because it is an important part. There are other areas in the Commission's nine sections that are also important, and the Commission did highlight those.

I will focus my remarks on areas of particular concern with respect to the price support program; a bit on Federal milk marketing orders; and perhaps touching a couple of the other items mentioned in the report.

What can we say about their price support program recommendations? A lot of the reaction I have heard so far, in the early stage of people having a chance to review this report might be as follows: no startling new ideas; no inspirations. A lot of it has a familiar ring. Maybe there is a sense of disappointment that there wasn't some new idea set forth.

Having tried to come up with new ideas myself for 10 years, I am a little bit sympathetic to the problem. And I think yes, it would have been nice to see something a little bit new to challenge our thinking.

But I think rather than focusing on specific recommendations, some of which indeed are very familiar, we may lose sight of the fact that there are some very important things that these gentlemen have laid before us that really get more at what they view as the goals of the program rather than the mechanisms of the program. And I want to talk about that.

I guess as I review the report, I would say, I do not think we should be too critical of things that the report did not do, but clearly, there are additional tasks that need to be done.

If we really want to look at these proposals they have presented us, we have to look at more specific things. We talk about formula pricing. What is the formula?

We talk about trying to use standby production management mechanisms. What are the specifics of those?

I would also like to see some empirical analysis. Given this, given that, what would happen under this program. That is work yet to be done.

But I do not think we should be too terribly critical of the report for failing to offer those details at this point.

What are some of the goals, objectives, philosophies that they discuss which, at least I think, may be more important than the mechanisms they propose?

Their discussion of the family farm is intriguing. And I think whether you like it or you don't like it is one issue, but where they came out on that I think is terribly significant.

And the notion they suggest that we cannot really come up with a family farm definition that we can use to guide policy decisions or select policy mechanisms is an interesting one.

I think I could take a shot at defining a family farm. But that is not the issue so much as can we use some definition to guide policy choices? They concluded not.

The question of targeting benefits versus having a program that has more or less equal price benefits to all farmers is interesting. They basically reject the notion of targeting benefits.

And of course, benefit targeting is a popular concept, and many folks are intrigued with doing that. Yet they say, well, we do not really think we can with the price support program.

They raise the issue of perhaps these should be addressed with other programs, although we are not left with details about how tax policy might be modified to target benefits.

Their relationship between economic objectives versus social objectives are important, and they basically say, we feel the price support program needs to focus on economic objectives; social objectives are perhaps more amenable to other tools.

Perhaps it is a valid criticism to say that they have defined away the nastiest part of this problem. And these social issues really are issues that we need to struggle with.

But saying that the price support program needs to focus on economic issues is a position that can be argued effectively.

They talk about recognizing economic realities, cost of production differences across regions and so on, versus political desirabilities or things that you would like to see happen socially; I think that is an important discussion.

As far as the mechanisms of the purchase program that they discuss and lay out for us, I want to highlight three areas if I may.

One is the notion of using purchases of dairy products as the main mechanism. Is this a good idea? They say, yes, let us continue with that. In the past I have argued that it is a very efficient way to move farm prices up and down.

But in the last several years it has struck me more and more that there are two aspects of this that have led to some difficulties, that have drawbacks.

Farmers are not aware of the benefits they receive under a purchase program, because they receive them indirectly through processors who sell products either to the CCC or on commercial markets. It leads to misunderstandings about: "do I receive benefits?" "I do not sell to the CCC." "My co-op does not sell to the CCC." Yet every farmer benefits through the existence of that program.

The other aspect that is a problem or a difficulty or a cause of misunderstanding is the relationship between CCC markets, if you will, and commercial markets. Does a processor have any incentive to develop commercial markets if Uncle Sam stands here with open hands?

Does the farmer who sells to the person who sells to the CCC know any difference? Is he at any disadvantage? I think not, and perhaps we are finding now this is a problem.

The price setting mechanism that is discussed in the report basically says, let us take a first stab at prices by using a formula, and then let us give it some adjustment, not to exceed plus or minus 50 cents.

That approach has been talked about a lot, and it can be made to work. I do not have any particular gripe about it, nor am I going to suggest it will not work.

But as I look at it, and I recognize that it is impossible to come up with the perfect formula—you have to have some kind of adjustment flexibility, we are really not that far off from saying next year's price is equal to this year's price plus or minus 50 cents.

Is the formula really going to do for us what we think it will? Do we need to go that far?

Thus, I am not totally comfortable with the price setting procedure, but on the other hand, I do not think it is a particularly big problem area.

Standby supply management programs—I have a hard time getting excited about these personally, and I am concerned about how these things can actually be made to be temporary, but I certainly would support talking about them further.

One aspect that I would like to draw to your attention that is confusing to me and perhaps can be explained further is, what happens to prices under the so-called two-tier or quota approach?

The implication of the Commission is that price adjustments would continue to occur. This is very much out of context with the traditional quota procedure, where you have a favorable price for your quota, and a very large penalty for overquota.

Is the implication here that we would keep the support price at $10.10 or $9.60 or what have you for that base production? In this case farmers simply pay large penalties on reductions that are mandated for all.

A related issue to this is the make-allowance discussion. There is I believe a bit of confusion; no confusion on intent, but perhaps confusion on mechanism.

For example, on page 101 of their full report, they say the California make-allowance should be made equal to the CCC make-allowance. On page 79, they say the California Class IV price should be made equal to the M–W price.

This sounds similar, but it is different. In fact if we want to talk about parity across California in Federal order pricing, the appropriate way to discuss that is by saying, the California Class IV price should be made equal to the Federal milk marketing order Class III price.

The make-allowance, while part of that calculation, is terminology that should not be confused.

If I might comment on the Federal milk marketing order components. Speed up the hearing process: good idea. There may be 2 years from the time you get a petition to the time you have a final decision. However, Federal order decisions are not simple decisions. You have to have a deliberate process that goes by some set of rules. And I know the Commission recognizes that, but I hope we all do recognize that, these decisions cannot be made hastily.

Two quotes, if I may, from the report: one is "MAS, meaning Federal order market administrators, should ratify marketing order programs requested by a majority of producers." If I have a majority and I ask for it, you ought to do it.

Second quote: "We should allow votes on individual amendments." This may be a subtle point. I think it is terribly important.

The USDA serves as an arbitrator between farmers, processors and consumers, or the public, in the hearing process. If farmers were permitted to simply say we want it by majority vote, and could pick items as they please, we would lose the ability of USDA to represent processors and consumers. And they are clearly interested and affected parties.

There is some concern I think about checks and balances. Dr. Jesse opens up a whole can of worms with Federal orders. I think this deserves a lot more attention than it is likely to receive today or at your next hearing. And I think it is a large and very important issue, but perhaps one that might be overplayed in its connection to a surplus problem.

And I will close my remarks there. Thank you.

[The prepared statement of Dr. Novakovic follows:]

STATEMENT OF ANDREW M. NOVAKOVIC, ASSOCIATE PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, CORNELL UNIVERSITY

Mr. Chairman, members of the committee, thank you for allowing me the opportunity to speak with you today about the final report of the National Commission on Dairy Policy.

The final report of the National Commission on Dairy Policy discusses nine major topics relevant to its charge. All parts of the report are important and should be read. I will focus my comments on the two major dairy policies, i.e. the price support program and federal milk marketing orders. I will touch briefly on a couple of other topics that I would like to highlight.

How Should the Report Be Viewed Generally?

The question of "do we like what the report says" aside, is this a good report? Did the Commission live up to its charge? Obviously we each will come to our own conclusions on such questions, but in my opinion they have made a very honest effort and offered a good report. The report leaves some gaps in how certain policy approaches would be specifically structured and implemented, and some of us would have liked to see some empirical examples and projections to support their recommendations. But, in fairness to the Commission it must be recognized that they covered a very broad waterfront in the time they had. Their recommendations are no more lacking in specificity and empirical justification than some of the legislation USDA has had to implement over the last several years. It is now up to others to look at the specifics and conduct empirical analyses. Perhaps the major theme of my comments is that the Commission's explicit and implicit statements about the appropriate goals for dairy policy are more important than their recommendations for dairy programs.

Dairy Price Support Proposals

Initial reactions to the Commission's report have been largely shaped by its recommendations relative to dairy price supports. The approaches they recommend contain elements that are very familiar to students of dairy policy in the 1980s. Hence much has already been said about criteria for setting support prices, supply management programs, and so on, and many of us have already made up our minds on the acceptability or desirability of approaches that the Commission endorses. Their price support program recommendations do not include any totally new approaches to grab our imaginations; hence they must be judged on how well the case is made that this combination of suggestions is indeed the best course of action. I surmise that how we react to these suggestions is determined mostly by what we think the dairy price support program should do -- what goals or objectives it should be judged by.

The program suggested by the Commission emphasizes a national orientation. They argue that each farmer's price should be affected about equally by the price support program. The procedures they suggest for setting and changing support prices derive from concerns about predictability in future pricing, and they try to balance a sense of fairness to individual farmers against the need to realistically assess marketwide supply/demand balances. Concerns for short term stability are addressed by limiting annual price changes. Non-price solutions are suggested when constrained price changes are not expected to work fast enough or have a large enough short term effect (particularly when markets are in surplus). In many ways the combination they suggest could be viewed as technical refinements to the basic approach laid out in current legislation.

Price Support Goals

More important than the mechanisms proposed by the Commission are the goals, objectives, and philosophy they discuss and espouse. Noteworthy is their treatment of the family farm issue, benefit targeting, and economic vs. social objectives.

Many readers have been surprised that the Commission decided it could not define a family farm. Far more significant than their refusal to adopt a definition according to size, income, or the use of family resources is their conclusion that defining a family farm serves no purpose, at least in the context of national dairy policy. They assert that almost all milk is produced by farm families; hence any good support policy will benefit family farms. They reject the argument that price support policy should be restructured so as to have benefits aimed more directly at family farms.

Similarly they argue against the concept of targeting benefits to groups of farmers defined by any other criteria, including regional location or milk utilization. This in part reflects a philosophy of "we're all in this together." It also results from their coming to the conclusion that the underlying economics of milk production cannot be changed by dairy policy.

The Commission also reaches a large conclusion when it states that federal price supports should be operated according to basic economic criteria aimed at nationally balanced markets. They argue that concerns for farmers unable to survive the rigors of incremental but steady price reductions are largely of a social nature and should be addressed by broader social programs.

That 18 dairy farmer leaders from across the country would come to these basic conclusions about the objectives for dairy price supports is nothing less than stunning. It would surely not have occurred 5 or 10 years ago, before the industry went through the trauma of the 1980s.

Price Support Mechanisms - The Purchase Program

The practice of supporting prices by having USDA offer higher prices for storable dairy products than would otherwise prevail in the market place, i.e. the purchase program, is an efficient way to support farm prices; however it may deserve further review.

I am convinced that part of the difficulty farmers have had in understanding and coping with policy issues during the 1980s stems from the fact that the purchase program is a mechanism that has been totally transparent to them. Farmers are not aware of the benefits they receive from price supports because these benefits come indirectly through dairy processors and wholesale markets for dairy products. This has led to an overemphasis on who sells to the CCC and comments like "I don't sell my milk to the government" (no one does) and "how can there be a surplus if so many buyers want my milk." A seemingly obvious solution to this problem would be to switch to direct payments, as is done in the feed grains program. It can hardly be said that the feed grains program is without problems; however these problems are not due to grain farmers bickering about whose fault the surplus is or not recognizing that they receive benefits.

Another problematic characteristic of the purchase program is that this approach has no mechanism for discouraging plants from selling to the CCC. To do so would be counter to the objectives of supporting farm milk prices; yet in a large surplus market it seems strange that processors who sell to the CCC have no particular incentive to cultivate commercial sales. The net returns to serving commercial markets are not necessarily better, and processors who sell on commercial markets are not necessarily able to offer their farmers any more market security or higher prices.

With respect to the price support program there are three kinds of processing plants. Those who produce products that cannot be sold to the CCC, those who sell to the CCC primarily on a seasonal basis, and those who sell to the CCC on a more or less year around basis. Farm pricing programs that have enough bite to encourage dairy farmers to coordinate milk production with seasonal changes in dairy product sales are not given enough attention as a solution to the very real and costly problem of seasonal balancing and the dilemma faced by processors who fall primarily in the second group. Processors who fall in the third group present another dilemma. In some sense, having plants heavily oriented to CCC sales on a year around basis may be a very efficient way to implement a price support program, but their very existence implies that we are resigned to a program of endemic surpluses.

The Commission, as many others do, argues that the purchase mechanism should be retained. Perhaps it should, but the problems it brings with it probably ought to be given more consideration.

Price Support Mechanisms -- Price Setting

The Commission calls for the use of a formula to establish a "first cut" at a support price. This formula price would then be subject to some discretionary adjustments within a plus or minus 50 ¢/cwt range. Given the impossibility of coming up with a perfect formula, some sort of supply/demand, productivity, and/or discretionary adjustments are inevitable. Perhaps it would be just as reasonable to simply decree that next year's price shall equal this year's price plus or minus no more than 50¢. Adjustments could still be made relative to a supply/demand adjuster or trigger mechanism, along the lines of current policy. Another approach might be to require that price adjustments be made subsequent to a collection of evidence at a hearing. This would allow for other factors to be considered and perhaps alleviate some concerns about giving the Secretary too much flexibility.

Some might argue that a hearing process would be too cumbersome, but this needn't be the case. Allowing the dairy industry input into the price setting decision could be a very positive step by projecting a sense of involvement and by explicitly recognizing that, with or without formula guidelines, prices are ultimately determined by judgment not arithmetic.

The Commission makes one short recommendation that could easily go unnoticed, i.e. to return to the practice of making annual adjustments to the support price on October 1. This may seem like a small issue but it has considerable merit and is particularly appropriate when prices are declining.

Price Support Mechanisms -- Standby Supply Management

The Commission recommends that supply controls be used to augment price cuts when CCC purchases are estimated to exceed certain levels. The decision rules would be much like those currently used to determine price cuts under current legislation; however they would have supply controls automatically come into play at a fairly moderate level of CCC purchases, i.e. before purchase levels became disastrously large. They suggest either of two mechanisms -- a voluntary buyout program (like the recent Dairy Termination Program) or a mandatory "two-tier" price program (which is simply a euphemism for a quota program in my opinion).

In general I think the buyout approach has some merit, more for social considerations than economic reasons. The two-tier/quota approach is less appealing, primarily for economic reasons. In either case, I think many reviewers are not sure just how temporary such "standby" programs would really be after they are first used. This concern is especially acute in the case of the two-tier/quota program, but could be an issue for an ongoing buyout program as well. An important factor mitigating such concerns is that the Commission would keep pressure on prices for as long as CCC purchases were projected to exceed acceptable levels. This is necessary if one is to prevent supply controls from becoming a permanent fixture. I am simply uncertain as to whether or not it is also sufficient to insure that temporary measures do not become permanent.

I would also suggest that the level of price under a two-tier/quota plan needs to be clarified. Typically this approach implies an attractive price for quota milk, and large penalties or a low price for milk in excess of the quota. Yet the Commission presents the two-tier/quota option in conjunction with declining support prices. In the case of a large surplus, does this mean that producers would face a lower support price and mandatory production cuts (mandatory in the sense that everyone would automatically face very low net prices on "excess" milk)? If so, this would be a very severe program.

The Make-Allowance Issue

The intent of the Commission regarding the make-allowance used to calculate Class 4 prices in California is clear. However, there may be some confusion about how to best describe and eliminate the discrepancies between prices milk used in manufacturing in California and other states. For example, on page 101 of their final report, the Commission speaks of equalizing the California make-allowance and the CCC make-allowance. On page 79, they speak of equalizing the California Class 4 price and the M-W price. This may look like the same thing but it is not. The pricing parity that the Commission argues for would exist if the California Class 4 price equaled Federal Milk Marketing Order Class III prices. Achieving this result would likely involve changing the California make-allowance, but the CCC make-allowance would not feature in the calculation and should not be the focus of the technical adjustment.

Federal Milk Marketing Orders

The Commission makes three suggestions upon which I would like to comment. First is their recommendation that the federal order hearing process be quickened. The Commission is appropriately retrospect in recognizing that order decisions should not be made hastily. While USDA probably does not need two years between an initial petition and a final decisions, good decisions and an appropriate hearing and review process will not be occur in a matter of a few weeks either. Undoubtedly some reduction in the hearing and decision process could be made, but in no case should we think that it could or should be a rapid process. It may also bear mentioning that an "emergency" procedure does exist for certain issues where a faster than normal, temporary response is indicated.

Two statements are made in the report that relate to this issue and also to the issue of how decisions should be made. On page 70 of the final report, it is stated: "Market administrators should ratify marketing order programs when requested by a majority of producers in the order." Page 71 adds: "administrative procedure [should be modified] to allow votes on individual amendments." These seemingly reasonable suggestions would prevent USDA from playing its role as an arbiter of farmer, processor, and consumer interests. Processors and consumers are clearly affected and interested parties; however they cannot vote on federal order changes. Some sort of checks and balances are needed. Adopting these recommendations would eliminate USDA's ability to administer the federal order program in the public interest and make them solely a tool for majority producer interests.

Page 70 also includes the statement: "Milk marketing orders should assure that Class I differentials meet Class I milk requirements without creating incentives for additional production for manufacturing purposes." This reminds one of a basic premise of the recent GAO report on federal orders, i.e. that class I differentials contributed to producer incentives to increase production between 1979 and 1986. It is beyond my capacity to understand how this could be, given that these differentials were constant during the 1970s and 1980s, until Congress raised them in 1986.

Certainly Class I differentials could be reduced as an alternative to reducing the support price, but that is a different issue. Moreover totally eliminating Class I differentials wouldn't do more than substitute for only one of the 50¢ cuts in the support price. And that requires one to believe that prices for milk used by fluid processors could be equalized with prices for milk used in manufacturing.

Probably the Commission had something other than the basic GAO premise in mind. It can also be argued that the large amount of milk used in manufacturing and priced under federals is inconsistent with the original intent of the federal order program. But, this begs questions about other ways to move class III milk out of federal orders. Even more importantly, it raises a host of very fundamental questions about the purposes of federal orders, the evolution of their use, and the role of an ever expanding manufacturing sector in the federal order program. Given the focus of this hearing, I will not belabor these issues now, but they deserve much more thoughtful attention than either the Commission or the GAO gives them.

Is the Technology Issue Adequately Addressed?

One of the motivations for establishing the Commission was to begin thinking about whether or not federal programs are capable of dealing with the potentially dramatic increases in productivity that could result from new technologies that appear near on the horizon. The report reviews new technologies and recommends 1) no unnecessary delays in federal approvals for safe technologies, 2) educational programs for users of production technologies and consumers of agricultural products produced with new techniques (biological or chemical), and 3) a greater emphasis on marketing research (as opposed to production research). These recommendations are fine as far as they go. But it seems to me that the question of whether federal policy is up to the task of dealing with the changes that new technologies may present is left hanging.

Dairy Product Trade

There has been considerable discussion within dairy industry circles about the opportunities for expanding export markets for U.S. dairy products. The Commission report conveys some of that, viz.:

> "Efforts to boost exports for market development should concentrate on low-income nations where markets do not now exist. Research should continue to develop products for foreign diets and lower-income nations."
>
> "There should be public and private funding of studies to ascertain which countries represent a potential market for U.S. dairy products and which countries are potentially self-sufficient...."
>
> "USDA should encourage the development of international markets ... by assisting industry-initiated activities through use of the Dairy Export Incentive Program, or by greater use of the Export Enhancement Program."

These are reasonably cautious statements. I would only add that I am doubtful that export markets can be profitably expanded to any significant degree. Any opportunities warrant careful study, and government encouragement in the short run may be justified. Nonetheless, I would opine that there is a tendency to underestimate the ability of third world countries to satisfy their own needs and overestimate our ability to develop profitable markets in low income countries.

Senator **Melcher**. Thank you. Dr. Butler.

STATEMENT OF L.J. "BEES" BUTLER, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF CALIFORNIA, DAVIS, CA

Dr. **Butler**. Thank you, Mr. Chairman. My name is Bees Butler. I am from the University of California at Davis, in California.

I would like to thank you for inviting me to give testimony here today, and I would like to take this opportunity of congratulating Mr. Clyde Rutherford and the members of the Commission for their report.

The Commission was set a difficult task, and I think that they did a very fine job of providing a report that will serve as an excellent basis for deliberations on dairy policy into the 1990's.

In general the report is fairly comprehensive, but I do not think that the report itself does justice to the breadth of the actual issues that are considered. For example, many of the recommendations in the text do not appear to have adequate documentation in the actual text of the report itself, and therefore, it is difficult to ascertain just precisely where the members of the Commission were going with some of their thinking when they made their recommendations. That tended to make the report appear to have some inconsistencies, and I think some of those inconsistencies have to be cleared up before a relatively comprehensive picture of the various recommendations emerges.

Let me address now some of the issues and recommendations, and I am just going to take them as they appear in the report. I thought the Commission's job on family farms was excellent, and it was in this section I think that perhaps some of their most lucid language was seen.

FAMILY DAIRY FARMS

I think they did an excellent job in researching and defining the issues that arise. Academics have been struggling for years with this problem of how to define a family farm; and I think their recommendations about not being able to do so is a very good one.

At the same time I think it is important that the Commission's recommendations do not preclude considerations of provisions or programs specifically targeted at certain sized farms where policies tend to discriminate against them.

For example, it has been known for some time now that large farms often capture a disproportionately large share of certain programs' benefits. And I think that programs that reallocate benefits in a more equitable fashion are both desirable and necessary.

MILK PRICE SUPPORT POLICIES

On milk price support policies, I certainly enjoyed seeing the endorsement of the members of the Commission for market orientation, and likewise that price should be a primary tool. As an economist, that is my job, to put that forth as a relatively good balancing tool.

I do have a problem with the indexing. I think the indexing only has a couple of minor advantages over what we currently have now. You could start splitting these 50 cent lots into smaller lots with an index. The other thing is that it might provide more planning tools for farmers. But, in general, there are also some disadvantages with using an index such as the one that they suggest. If you are going to, for example, focus in on the cost of production, which the members of the Commission themselves say in a different part of the report, vary widely across regions and across individuals within regions, I think you are going to have a difficult job coming up with the cost of production base.

Likewise, technology, I think that is a very difficult thing to take account of when it is not adopted evenly or evenly distributed across regions in this country.

Just following up on that a little bit, in many ways I think that the current flexible price support program is a sort of an index or a formula; it goes up and down by 50 cents, as Dr. Novakovic pointed out. Its simplicity is relatively appealing. I think it is probably an adequate supply and demand balancing tool. As far as planning tools are concerned, I think that perhaps if the Secretary of Agriculture were to take up the recommendation of issuing quarterly CCC purchases and allocations, then that might well be an adequate planning tool for most of the dairy farmers as well—or most of the dairy industry, I should say, not just dairy farmers.

STANDBY PRODUCTION CONTROLS

Standby production controls I think is a very interesting concept. It gives recognition to the fact that when you are trying to control by prices only, there are certain lags in the system, certain lags and leads. And I think they need to be recognized as far as dynamic supply responses are concerned. For example, economics would suggest that if we had a cut in price supports, then we would get a reduction in the supply. That is obviously not what is happening, and for very good reasons. Obviously, many producers are producing more at the moment to offset the income reduced by a price decline. The standby controls, of course, would speed up the process of achieving that, and that has some interesting implications for dairy policy.

FEDERAL MILK MARKETING ORDERS

In regard to Federal milk marketing orders, we do not have much to say. Californians are likely to be relatively passive in this area. I think that the recent GAO and the current USDA studies on this issue will probably throw more light on the appropriate actions to be taken.

REGIONALISM

On regionalism, I think in general the Commission's report or recommendations on regionalism were very well researched and fairly lucid. In principle, I would agree with most of the recommendations that the Commission has on regionalism. However, I have to take some sort of reservation at pointing the finger and almost being inconsistent with their own recommendations.

THE CALIFORNIA MAKE-ALLOWANCE

The California make-allowances—and I see my time is up, and I am not going to go into this a great deal, except to say that I do not think that the make-allowance should be federally mandated. I do not think there is any reason to federally mandate a make-allowance in California. As both of my colleagues have pointed out, the make-allowance is an issue that is buried in the details and technicalities of a milk marketing order, and probably ought to be best considered at the State level.

FOOD SAFETY AND PRODUCT IDENTITY STANDARDS

Food safety and product identity standards, again an important area, and I think one that we need to take some of the recommendations which the Commission has made into account. I do have some reservations about the Commission's recommendations with respect to State laws that supersede the Federal standards. Many State laws are the innovative driving forces behind many of the other laws that we have at the Federal level or uniform State laws. So I do not think that necessarily putting away or forbidding individual State laws from superseding Federal standards is necessarily a good idea. I think States are just as innovative as individuals can be at times.

TRADE AND AID PROGRAMS

Finally, I find here that the Commission's recommendations were rather narrowly focused on the dairy industry, and it is difficult to reconcile some of the recommendations that the Commission made with some of the desirable changes for free trade. I will not go into what I was going to say. It is in my prepared testimony; you have that. But I find a couple of the recommendations a little inconsistent.

CONCLUSION

So, in conclusion, I think the report has relatively mixed blessings. Some of the recommendations are in line with current thinking, some new and innovative ideas, which I think merit attention, but many of the apparent inconsistencies, I think, will have to be clarified before a cohesive plan emerges from that report.

This concludes my testimony, Senator, and you have copies of my written testimony. I will be glad to answer any questions that you might have.

[The prepared statement of Dr. Butler follows:]

TESTIMONY BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

L. J. Butler
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April 28, 1988

Mr. Chairman and members of the Senate Committee on Agriculture, Nutrition and Forestry, thank-you for the opportunity of appearing before you today to comment on the Report and Recommendations of the National Commission on Dairy Policy. I would like to take this opportunity to congratulate Mr. Clyde Rutherford and the Commissioners of the Dairy Policy Commission for the task they have carried out in preparing this report. The Commission was set a difficult task, and I believe they have provided a report that will serve as an excellent basis for deliberations on dairy policy into the 1990s. I believe the report has some innovative suggestions that may be considered in the dairy provisions of the 1990 Farm Bill.

In general, the Report and Recommendations of the Commission is comprehensive and far-reaching. However, the report does not do justice to the breadth of issues that are considered. For example, many of the recommendations are not backed up by adequate documentation in the text of the report. As a consequence, many of the recommendations appear to be inconsistent. It will take some time to sort through the various appendices that attach to the report before a comprehensive picture of the underlying reasoning behind many of the recommendations becomes clear. It is of course inevitable that some inconsistencies appear in a report of this type since the Commissioners were concerned more with broad principles rather than the micro-analytical details of policy. Nevertheless, this will obviously be a source of some criticism of the report.

I would like now to address some of the issues and recommendations raised by the Commissions report as they pertain to the Western states. I will take them in the order they appear in the report.

1. Family Dairy Farms

The commissions considerations of family farming is commendable, and it is in this section of the report that they offer some of their most lucid reasoning. The Commission has done an excellent job in researching and defining the difficult issues that arise in connection with "family farm" operations. Academics have been struggling with this question for years and most would likely agree that attempting to define a "family farm" is difficult, and in most cases unworkable. The Commissions conclusion that policy should create an economic environment in which the "family farm", by any definition, will survive, is highly commendable. However, I think it is important that the Commissions recommendations do not preclude consideration of provisions or programs specifically targeted at certain size farms where policies tend to discriminate against them. For example, it has been known for some years that the benefits of certain farm programs are distributed disproportionately to large farms that have the resources to capture them. Programs that reallocate benefits in a more equitable fashion are both desirable and necessary to protect those with limited resources.

2. Milk Price Support Policies

The Commissions endorsement of a dairy policy that is market-oriented is not only commendable but necessary for the efficient functioning of U.S. agriculture. I believe that the Commissions recommendation that prices should be the primary tool to balance supply and demand imbalances is crucial for the efficient allocation of resources in agriculture. In this sense, the Commission appears to endorse the flexible price support program currently enacted under the Dairy provisions of the Food Security Act of 1985. However the desire to index or establish a formula to determine the level of price support for milk leaves me with some reservations. An index or formula has two advantages over the current flexible price support mechanism. First, it would make it possible to make incremental changes between the current 50 cent changes that occur. Second, it would provide a beneficial planning tool for dairy producers and processors that may decrease uncertainty and increase stability. However, there are certain difficulties in relying on a formula that accounts for production costs and advances in technology. Production costs, as the commission points out in another section of the report, vary tremendously across regions and across individuals within a region. Finding a suitable national production cost base would be difficult and may distort signals in some regions. Similarly, advances in technology are difficult to account for when adoption and diffusion of a technology is not evenly distributed across regions.

In many ways, the current flexible price support mechanism is an index or formula. It's simplicity is appealing and is probably adequate as a supply/demand balancing tool. If the Secretary of Agriculture were to take up the Commissions recommendation of making quarterly evaluations and projections of CCC acquisitions and disposals, this would probably be a sufficient planning tool for most of the dairy industry.

3. Standby Production Controls

The Commissions concept of standby production controls that would be triggered based on projections of CCC purchases in excess of some "action level" is an interesting proposal. The concept gives recognition to the fact that while price is the primary balancing tool, there are certain lags involved in the dynamics of supply response that impede the intentions of a price cut in the short-run. For example, economic theory would suggest that a reduction in price supports would result in a decrease in the quantity produced. In the short run however, producers will tend to react to a decrease in prices by increasing production to offset a decline in income. As prices continue to decrease, dairy producers will continue to increase production until economies of size or cost-cutting strategies are exhausted and it is no longer profitable to produce milk. At this stage they would exit the industry and milk production will decline due to attrition in the industry. That is, under the current flexible price support program, milk production will increase before it decreases.

Under these circumstances, a standby production control program, as suggested by the Commission, would achieve a balance in milk supply and demand faster than a price reduction alone would achieve.

With respect to the concept of having two programs available at the discretion of the Secretary of Agriculture, and to the choice of programs, both are creative ideas that merit consideration. In general, Western dairy producers prefer voluntary as opposed to mandatory programs. There seems to be no reason why a two-tier pricing program could not be voluntary. The alternative could be exclusion from the price support program.

4. Federal Milk Marketing Orders

There does not appear to be much in the way of "controversial" material in the Commissions recommendations for Federal Milk Marketing Orders. Most Western dairy producers would likely agree that the recommendations are in-line with current thinking. Since Federal orders do not affect California, the dairy industry in California is likely to be passive with respect to the recommendations. Many of the commissions recommendations already exist in California's state order system.

Many of the recommendations made by the Commission in this section are not well documented, either in the report, or in the executive summary. For example, one recommendation is that legislation should not create a single national milk marketing order -- but the report does not address this issue. The recent GAO report and current USDA study on these issues should not be precluded from consideration in future deliberations on Federal Milk Marketing Orders.

5. Regionalism

The Commissions documentation on the issue of regionalism is lucid and well researched. In principle, the Commissions review of regionalism reflects a need to recognize that all dairy producers operate ultimately in a national market, not in regional markets. Attempts to pin the blame on any region for surplus production tends to hamper the correct identification of a national problem. It is perhaps surprising then that the Commission would see fit to recommend that "Federal law should prohibit California, or any other state, from using a greater allowance to establish a grade A price for milk used for manufacturing butter nonfat dry milk and cheese". Many people would see this as a direct contradiction to the Commissions sentiments on regionalism. I would like to address this issue in a separate section.

6. The California Make Allowance

Historically, the California make allowances used in the determination of Class 4 prices have been set to allow the higher cost manufacturing plants in the state to earn an adequate return. The rationale has been that due to California's geographical isolation, the state cannot afford to have inadequate manufacturing capacity, thereby requiring surplus milk to move large distances east for manufacturing or to be dumped. Thus, the state has attempted to encourage adequate manufacturing in the state by regular updating of the make allowance to keep it current with plant costs. Similarly, with the fortification allowance for the manufacture of lowfat and skim milk.

In contrast to the federal make allowances, currently at $1.22 for butter and powder and $1.37 for cheese, the California make allowance is relatively generous. There is only one make allowance in California (based on butter-powder plant costs) and it is currently set at $2.06 per cwt.

How is this difference reconciled?

Processors in Federal orders cover the excess costs of manufacturing butter, powder and cheese by charging over order premiums to fluid milk processors, and/or, in the case of a cooperative, by keeping the retains of its members. Over-order premiums do not exist in California, and cooperative retains are returned to the members in the form of a 13th check. Perhaps the Federal order system of recovering the excess costs of manufacturing needs to be examined by California processors.

The make allowance has become a contentious issue in California in recent years. In contrast to the mechanism for USDA support prices, when make allowances for butter and powder in California are changed, Class 4 prices move in the opposite direction. Thus, if the make allowance is lowered, Class 4 prices increase, and vice versa. Some producers argue that the generous make allowance encourages surplus production because plants are encouraged to maintain year-round capacity. Processors and manufacturers on the other hand, argue that there is a need to maintain in-state processing capacity, and that lowering the make allowance would both discourage adequate in-state processing capacity and encourage surplus production because Class 4 prices would be higher.

There do not appear to be any easy answers to these charges since both arguments contain an element of truth. There is no evidence that higher make allowances encourage surpluses, although it would certainly make economic sense for processors to encourage production to utilize capacity. Likewise, historically producers have increased production regardless of the direction of manufacturing milk prices. If the price goes down, producers produce more to maintain income. If the price goes up, it is taken as a signal to increase production, and may attract more producers into the dairy industry. Thus, the make allowance issue is a difficult one. Lowering the make allowance to discourage capacity in an attempt to limit production drives Class 4 prices up, thus increasing the potential for increased production. But the ultimate limit to milk production in California is in-state processing capacity.

The Commissions conclusion that California's make allowance interferes with the Federal price support program appears to be a hasty one because there is little evidence to support this argument. While I cannot refute the argument that the "generous" make allowance does afford a marginal advantage to processors in California over processors in other states, this could be considered as a marketing advantage rather than an unfair advantage. I do think that California needs to thoroughly examine its make allowance, but I do not think it should be Federally mandated.

7. Food Safety and Product Identity Standards

In recent years, some of the concern over food quality has focused on the dairy industry due to media reports of chemical and microbial contamination of milk. While most milk and dairy products are safe, the demand for milk and dairy products depends heavily on consumer confidence in the quality and safety of these products. The Commission recommendations in this regard are therefore commendable. However I do have reservations about the

Commissions recommendations with regard to individual state laws and regulations that supersede federal standards. Many state laws and regulations have, in the past, been the innovative driving force behind Federal or uniform state laws. Californias Proposition 65 is a well intentioned piece of legislation voted on in a referendum by a large majority of California voters. It was intended to make California's water resources and agriculture and food system safer, and to increase consumer confidence in it. While it is true that Proposition 65 has had the effect of putting the responsibility of maintaining higher standards on individual producers, in the long run the effects will be beneficial for both producers and consumers. However, I agree that Federal standards should be set.

8. Trade and Aid Programs

The recommendations of the Commission on international trade issues seems to be focused closely on the dairy industry. While this was precisely the Commissions charge, it is difficult to reconcile many of the desirable changes with respect to trade, with the recommendations of the Commission. For example, the Commission have chosen to accept the proposition that imports of casein interfere with the price support program by increasing the amount of powder purchased by the CCC. This, despite the recent studies of the U.S. Department of Agriculture (USDA) and the International Trade Commission (ITC) that the volume of casein imports does not significantly interfere with the CCC purchases of manufactured dairy products. If the Commissions recommendation, that casein be reclassified as a dairy product and subjected to Section 22 import quotas, is carried out, then the U.S. government may have to heavily subsidize domestic casein production more than is directly provided for under the Food Security Act of 1985. Besides which, it is not at all in the spirit of free trade.

Concluding Comments

In conclusion then, the National Commission on Dairy Policy's report and recommendations has some mixed blessings. Some of the recommendations are in-line with current practice and provide an impetus for eventual incorporation into dairy policy. Others are innovative and merit some attention. But the Commission needs to clarify some of the apparent inconsistencies before a cohesive plan emerges from the recommendations.

The Commissions conclusion that those farmers who cannot compete need to get out of dairying is, in my opinion a correct one. Yet there obviously still exist many dairy producers who are "locked" into agriculture because their fixed asset base prevents them becoming more efficient or from exiting easily. This too is a potential problem that needs to be addressed.

Senator MELCHER. I suppose over the next generation, 24 years from now when somebody is reviewing this report, they might be at a loss to understand just what the tinkering with the price support mechanism or marketing orders had meant over that 24-year period.

But it interests me that all three of you have just skimmed through the export side of this report. Dr. Butler, you stated in your prepared testimony—I do not know whether you mentioned it in your summary. But in your prepared testimony that you submitted, you stated about casein, but none of the others, as far as I can tell, get into exports. Do any of you get into export of dairy products?

Dr. BUTLER. Senator, it is very difficult to get into exports at this stage. Current prices for U.S. products are about twice what they are on the world market. Now, admittedly, on the world market those are subsidized prices. But we have such a small export trade in dairy products, and I cannot see it expanding greatly in the near future unless we do something about the prices.

Senator MELCHER. We are getting rid of grain, though, aren't we?

Dr. BUTLER. That is correct.

Senator MELCHER. You are aware of that. How do we get rid of it in export?

You do not know? We subsidize it. We subsidized corn, for instance. What is the rule of thumb in pounds of corn relative to a pound of dry powdered milk?

Dr. JESSE. You mean in value?

Senator MELCHER. Pounds, value, dollars, cents.

Dr. JESSE. Current price, Commodity Credit Corporation price for nonfat dry milk is slightly above 70 cents. Corn price right now in international markets is, what, $1.70.

Senator MELCHER. How many pounds of corn in that pound of dry milk?

Dr. JESSE. A 56-pound bushel.

Senator MELCHER. How many pounds of corn went into that pound of dry powdered milk?

Dr. JESSE. That I cannot tell you.

Senator MELCHER. Maybe some of these producers know. We will get to that later.

It would seem to me what history will record during the next generation regarding milk is not so much on what the 1988 or 1989 marketing order situation was or what the exact price support mechanism was. It might record whether there was any expansion of dairy exports. Since we all subsidize, what is wrong with subsidizing the export of the dairy products? Is there anything wrong with that?

Dr. JESSE. In the strict terms of equity with the rest of the commodities, certainly not. We already are in terms of the Dairy Export Incentive Program and some very large exports through Public Law 480. So we are giving away quite a bit of dairy products out of our Commodity Credit Corporation stocks, or were until they were diminished to the point where there is not enough available for large exports at this point.

Senator MELCHER. I do not think any of you are prepared to answer, but I ask you to consider, at least, in your academic roles and practical advice to the industry, whether it might be more beneficial to export the grain and milk or cheese or butter. Do any of you have any thoughts on that?

Dr. **Novakovic**. Senator, I think that would be awfully difficult. Now, the question that President Reagan raises in his proposal——

Senator **Melcher**. What would make it difficult?

Dr. **Novakovic**. What is our ability to price product that will sell on international markets, and that raises a whole slew of questions about what would be the reaction of those people currently serving international markets. What would they do to try to keep their markets?

Suppose we had this level playing field that President Reagan would like to see——

Senator **Melcher**. Well, we do not.

Dr. **Novakovic**. We do not.

Senator **Melcher**. So let us not talk about it.

Dr. **Novakovic**. OK.

Senator **Melcher**. Let us talk about where we are at.

Dr. **Novakovic**. All right, fine. Let us do that.

Senator **Melcher**. Let us talk about it in relation to an Export Enhancement Program for grain.

Dr. **Novakovic**. OK. Well, I cannot speak very well on grain. It is not an area I would claim any expertise at all. But I certainly do know that we face tremendous price competition on serving international markets with our dairy products. Could we be subsidized to the point where we could compete in those? Are our products good products? Would people be willing to buy them if the price was right? Absolutely. No question about that. There is no issue there.

The question is: Do we want to pay that price? Is that the direction we want to go? That confronts Federal budget issues; that confronts trade issues. We will be lucky to keep section 22 going.

Senator **Melcher**. I will give you the answer to that. The answer is yes, we do, because we spent about $26 billion in fiscal year 1987 on the farm program. We want to reduce that, and one of the ways we are going to reduce it is to get rid of the grain so we do not spend so much in deficiency payments for corn and other feed grains and for wheat. So the answer to the willingness to fund the program is yes.

I just pose this question, I guess, as food for thought for you folks. By the way, you cannot help being knowledgeable in what the Export Enhancement Program is for grain and what it does and what it costs if you sit around this table. We have to know that and have to know why we are doing it and why we should do more of it. The simple reason we have to do more of it is to get rid of the surplus grain so the price will come up in the world market. Then we will not have to put out so much in deficiency payments to our producers. That is the long and the short of it.

My suggestion to the three of you is that it might be cheaper to export the grain through dairy products than it is to export the grain itself.

Dr. **Butler**. Highly possible, Senator.

Senator **Melcher**. All right. Thank you all very much.

Our last panel is Tom Camerlo, Irvin Elkin—Tom Camerlo will be accompanied by James Barr. Tom Camerlo is president and James Barr is chief executive director of the National Milk Producers Federation.

And we have also Irv Elkin, president of Associated Milk Producers, and Lin Tipton, president of the Milk Industry Foundation.

All right, Tom. Please proceed.

STATEMENT OF JAMES P. (TOM) CAMERLO, PRESIDENT, NATIONAL MILK PRODUCERS FEDERATION, ARLINGTON, VA, ACCOMPANIED BY JAMES C. BARR, CHIEF EXECUTIVE OFFICER

Mr. **Camerlo**. Thank you, Mr. Chairman.

My name is Tom Camerlo, and I am a farmer from southern Colorado. I appreciate this opportunity to appear before the committee to discuss the recent report and recommendations of the National Commission on Dairy Policy.

My remarks here today are in my capacity as president of the National Milk Producers Federation and are based on the organization's policy positions. But before examining some of the Commission's key recommendations, I want to take just a moment to express the honor and privilege I experienced in serving as a member of this Commission.

The 16 months I spent working with my fellow commissioners was a rewarding, educating, and an enriching time. When we began, I recall clearly the strong differences of opinions which existed among all of us on virtually all of the major policy issues. Slowly, as we worked on these issues and heard from producers, handlers, and consumers around the country, our differences became less pronounced.

I think all of us learned a great deal in this process. We came to realize that many preconceived notions and parochial viewpoints may play well in a particular region of the country, but they are simply not relevant to the task of suggesting recommendations on the future of national dairy policy.

By its very nature, the Commission's report is not going to meet everyone's approval. It is a document reflecting the give and take of 18 independently minded dairy farmers working to forge a consensus on future policy. I may not agree with every recommendation in this report—and that is probably true for each of my colleagues—but taken together, the report can serve as a useful blueprint for the debate over the Nation's future dairy policy.

In examining the report's major recommendations on the dairy price support program, I think it is important to remember the background of the 1985 farm bill out of which this report has emerged.

The National Milk Producers Federation had advocated permanent authority for a standby voluntary supply management program to be implemented whenever milk production was building to burdensome levels.

Clearly, the supply management feature of the farm bill achieved its intended short-term goal of reducing milk production and reducing Federal dairy program costs.

But upon the program's completion, milk production began climbing slowly, and in the absence of a supply management program to reduce output, both Government dairy purchases and program costs began increasing.

This is why the Commission's recommendation for standby supply management authority is so important. The supply management programs we have used in the 1980's have been successful. But their success has been limited by the Government's unwillingness to utilize them as long-term standby programs. In each case, the supply management approach has been used as a short-term, one-shot deal.

I think it is less important what type of supply management program is utilized than it is that such program authority be available on a standby basis. Either the voluntary approach of a dairy termination program or the full participation approach embodied in a two-tier price concept will achieve the desired result of reducing excess milk production. The key issue is not which program is used by the Agriculture Secretary, but rather that the Secretary be required to implement one of them at a certain trigger point.

The Dairy Policy Commission's report advocates that production controls should be used only when price changes alone will not balance supply with demand in a reasonable time period without greatly disrupting the market for dairy products. The report is clear in its belief that market forces, together with adjustments in the Government support price, should balance supply and demand for milk and dairy products.

Also central to the Commission's report is the need for a formula to set and adjust the support level each year at prices near market equilibrium levels. The Commission did not develop a specific formula for adjusting price support levels, but it called for development of a pricing index which would include such factors as milk production cost, productivity advances, and consideration of consumer purchasing power.

Like the report's recommendations for a standby support price index, the use of a formula to adjust support prices instead of the current politically determined price adjustments is strongly supported by the National Milk Producers Federation.

Up to this point, the Dairy Policy Commission's recommendations I have discussed are generally consistent with the policy of National Milk Producers Federation. However, since we have not yet developed official policy on the report, it is more difficult at this time to advise the committee on the report's recommended use of price cuts when projected USDA dairy product removals exceed 5 billion pounds.

The Commission's report generally recommends a reduction in the price support level when dairy program purchases are estimated to exceed a market balancing level.

The Federation's policy agrees that the support price is designed to stabilize market prices, but not to be the market price over an extended period of time. Therefore, it is vitally important that we achieve and maintain a supply-demand balance to encourage market growth and enhance farm income.

However, it does not necessarily follow that such a balance should be achieved primarily through price reductions. We are concerned by the support price cuts contained in the 1985 farm bill. Rather than institute additional price cuts, we believe today the Secretary of Agriculture should use the authority Congress gave him to achieve the needed small reduction in milk production through a voluntary supply management program.

Beyond the Commission's recommendations on the dairy price support program, there are also numerous recommendations which, if adopted, would vastly improve the well-being of the Nation's dairy farmers.

I urge the committee to pay particular attention to the report's recommendations on international trade and the potential impact of the General Agreement on Tariffs and Trade [GATT] negotiations now under way in Geneva. The Nation's dairy industry is vitally concerned over the potentially devastating impact of a GATT agreement which would increase imports of dairy products and cripple our efforts to achieve a domestic supply-demand balance.

In closing, let me say that I hope this committee will closely examine the recommendations contained in the report of the National Commission on Dairy Policy. In doing so, I believe you will find the report, on balance, contains many important suggestions for the Nation's dairy policy. To be sure, none of us will agree with every recommendation in the report. But let us use those differences to focus our collective efforts to mold a better future for the Nation's dairy farmers.

Thank you very much for this opportunity.

[The prepared statement of Mr. Camerlo follows:]

national milk producers federation

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James C. Barr, CAE
Chief Executive Officer

The National Milk Producers Federation is a national farm commodity organization representing virtually all of the dairy farmer cooperatives and their dairy farmer members who serve this nation by producing and marketing milk in every state in the Union.

Since its inception in 1916, the Federation has actively participated in the development of dairy programs which are a part of a total system of agricultural law and policy which can appropriately be termed a national food policy.

The policies of the Federation are determined by its membership on a basis that assures participation from across the nation. The policy positions expressed by NMPF are thus the only nationwide expression of dairy farmers and their cooperatives on national public policy.

STATEMENT OF

JAMES P. (TOM) CAMERLO
PRESIDENT
NATIONAL MILK PRODUCERS FEDERATION

To

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE

With Respect To

REPORT OF THE NATIONAL COMMISSION ON DAIRY POLICY

APRIL 28, 1988

STATEMENT OF JAMES P. (TOM) CAMERLO
PRESIDENT, NATIONAL MILK PRODUCERS FEDERATION

Mr. Chairman:

I am Tom Camerlo, President of the National Milk Producers Federation. I also serve as President of Western Dairymen Cooperative, Inc. a 1500 member co-op serving dairy farmers primarily in Colorado, Utah, Idaho and Wyoming. I appreciate this opportunity to appear before the Committee to discuss the recent report and recommendations of the National Commission on Dairy Policy.

At the outset, I'd like to provide a brief description of the Federation for the record. The National Milk Producers Federation is the national farm commodity organization which represents dairy farmers and the dairy cooperative marketing associations they own and operate throughout the United States.

The bulk of the nation's milk supply is marketed through dairy cooperative marketing associations which farmers have developed to represent them in the market. The marketing activities of these associations range from bargaining for price and other conditions of sale of bulk fluid milk to the production of finished dairy products and the distribution and retail sale of such products to consumers. Virtually every dairy product that is produced in any substantial quantity in the United States is included in the product mix of the cooperatives represented by the Federation.

The National Milk Producers Federation provides the vehicle through which dairy farmers and their cooperative marketing associations formulate policy on national issues which affect their ability to produce and market milk and dairy products. The Federation and its membership seek to establish conditions under which farmers can join together to market their products in stable markets at prices which are reasonable both to producers and consumers.

Since its founding in 1916, the Federation has worked with the Congress and the executive agencies to secure the adoption of laws and the implementation of policies to further these basic goals.

The membership of the National Milk Producers Federation is directly concerned with the development and implementation of policies that ensure that the nation has an adequate supply of high quality milk and that the total supply of such milk is not excessive with respect to commercial market requirements. Thus, we have a very keen interest in the recommendations of the National Commission on Dairy Policy.

My remarks here today are in my capacity as President of the Federation and are based on the organization's policy positions. But before examining some of the Commission report's key recommendations, I want to take just a moment to express the honor and privilege I experienced in serving as a member of the Commission.

The 16 months I spent working with my fellow commissioners was a rewarding and enriching time. I recall clearly the strong differences of opinions which existed among us on virtually all the major policy issues when we began our work back in November of 1986. Slowly, as we worked on these issues and heard from producers and other interested parties in the 10 field hearings we held around the country, our differences became less pronounced.

I think all of us learned a great deal in this process. We came to realize that many preconceived notions and parochial viewpoints may play well in a particular region of the country, but they are simply not relevant to the task of suggesting recommendations on the future of national dairy policy.

This is a dynamic and productive industry. The task for everyone concerned about its future -- and that of the nation's dairy farmers -- is to suggest policies which will foster and enhance this dynamism by assuring adequate income to maintain productivity while controlling federal program costs. In my view, the recommendations in the report of the National Commission on Dairy Policy, on the whole, meet this test.

By its very nature, the Commission's report is not going to meet everyone's approval. It is a document reflecting the give and take of 18 independently-minded dairy farmers working to forge a consensus on future policy. I may not agree with every recommendation in the report --and that's probably true for each of my fellow commissioners -- but taken together, the report can serve as a useful blueprint for the debate over the nation's future dairy policy.

In examining the report's major recommendations on the dairy price support program, I think it is important to remember the background of the 1985 farm bill out of which this report has emerged. After the difficult and grueling debate in Congress over the 1985 farm bill, many of us in the dairy industry were concerned with the continued unwillingness of federal policy makers to enact a long term dairy program.

The National Milk Producers Federation had advocated permanent authority for a standby voluntary supply management program to be implemented whenever milk production was building to burdensome levels. The Federation recommended that the Secretary of Agriculture be required to implement a dairy diversion or dairy termination program if milk production was projected to exceed market needs by more than an acceptable predetermined level.

But Congress did not adopt as permanent authority the provision for standby supply management program. Instead, the Food Security Act of 1985 contained a requirement for an 18 month dairy termination program to eliminate 12 billion pounds of milk production.

Beyond that, the legislation provided a series of price cuts on January 1, 1988 through 1990 if USDA projected annual government dairy product purchases in excess of five billion pounds, milk equivalent. The farm bill contained only discretionary authority for the Secretary of Agriculture to implement further supply management programs to bring supply in line with demand. To date, the Secretary has been unwilling to use that discretionary authority.

Clearly, the supply management feature of the farm bill achieved its intended goal of reducing milk production and reducing federal dairy program costs. Through the dairy termination program nearly 14,000 dairy farmers opted to dispose of their herds through slaughter or export and leave the business. These producers represented about 12.3 billion of milk, or about 8.7 percent of total 1985 U.S. production. Over 1.2 million dairy cows, heifers and calves were disposed of under the program and another 66,000 were exported.

The dairy termination program reduced America's dairy herd to its lowest point in modern history and cut both government surplus purchases and total federal program costs in half.

But upon the program's completion, milk production began climbing slowing, and in the absence of a supply management program to reduce output, both government dairy purchases and program costs began increasing. Thus, even though Agriculture Secretary Lyng reduced the dairy support price by 50 cents per hundredweight on January 1, USDA is still forecasting that net government dairy product purchases this year will be 8.6 billion pounds.

This is why the Commission's recommendation for standby supply management authority is so important. The supply management programs we have used in the 1980s have been successful. But their success has been limited by the government's unwillingness to utilize them as long-term standby programs. In each case the supply management approach has been used as a short-term, one-shot deal. Viewed in this context, it should surprise no one that we are still struggling to achieve a long-term balance between milk production and consumption.

I think it is less important what type of supply management program is utilized than it is that such program authority be available on a standby basis. Either the voluntary approach of a dairy termination program or the full participation approach embodied in a two-tier price concept will achieve the desired result of reducing excess milk production. The key issue is not which program is used by the Agriculture Secretary, but rather that the Secretary be required to implement one of them when dairy product purchases by the government are projected above a certain level.

The dairy policy commission's report advocates that production controls should be used only when price changes alone will not balance supply with demand in a reasonable time period without greatly disrupting the market for dairy products. The report is clear in its belief that market forces, together with adjustments in the government support price, should balance supply and demand for milk and dairy products.

To adjust support prices, the Commission argues for a better method than the current mechanism which authorizes adjustments of $.50 per hundredweight each year based on the projected level of USDA dairy product purchases.

The Commission report advocated use of a formula to set and adjust the support level each year at prices near market equilibrium levels. The Commission did not develop a specific formula for adjusting price support levels, but the report does suggest that such a formula should be designed to assure adequate supplies of milk without generating large surpluses. To provide greater assurance that the formula-derived support price reflected actual market conditions, the Commission recommended the Secretary of Agriculture have discretionary authority to adjust such price by up to five percent, but no more than $.50 per hundredweight, annually.

Like the report's recommendations for standby supply management authority, the use of a formula to adjust support prices instead of the current politically determined price increments is consistent with the policy of the Federation. We developed a dairy specific pricing index for inclusion in the 1985 farm bill. That index was contained in legislation adopted in 1985 by the House of Representatives.

The Commission said it was not satisfied with the Federation's formula, indicating that it appears to generate a support price that exceeds equilibrium prices. We will examine the Commission's comments on the Federation's pricing index and consider whether changes should be made in the index.

Before discussing the report's recommendations on adjusting price support levels, I want to look briefly at the issue of regionalizing the dairy price support program. The National Milk Producers Federation has long supported the basic federal legislation authorizing the dairy program and views the national scope of the support program as central to its effective operation.

The Commission's report argues strongly against regionalizing the support program, viewing such proposals as an attempt to protect milk producers in a particular geographic area from the impact of basic market forces. The Commission report says it would "lead to economic distortions that would subsidize milk production for manufacturing uses in high-cost markets."

While the Federation has not adopted a specific position on proposals to regionalize the dairy price support program, our general policy view is to maintain the program's national focus. We view the federal milk marketing order program as the appropriate policy instrument to address regional milk marketing and pricing issues.

Up to this point, the dairy policy commission's recommendations I have discussed are generally consistent with the policy of the National Milk Producers Federation. However, since we have not yet developed official policy on the report, it is more difficult at this time to advise the Committee on the report's recommended use of price cuts when projected USDA dairy product removals exceed five billion pounds.

The Commission is explicit in recommending a reduction in the price support level when dairy program purchases are estimated to exceed a market balancing level. If government purchases are still estimated in excess of the market balancing level by a certain amount after the support price is reduced, then the Commission recommends that a supply management program be implemented.

The Federation's policy agrees that the support price is designed to stabilize market prices, but not to be the market price over an extended period of time. The income of the nation's dairy farmers comes from the commercial sale of dairy products. Therefore, it is vitally important that we achieve and maintain a supply-demand balance to encourage market growth and enhance farm income.

However, it does not necessarily follow that such a balance should be achieved primarily through price reductions. We are concerned by the support price cuts contained in the 1985 farm bill. Rather than institute additional price cuts, we believe the Secretary of Agriculture should use the authority Congress gave him to achieve the needed small reduction in milk production through a voluntary supply management program.

When there is better balance among agricultural commodity prices, the Commission's price recommendations may be viewed in a different context. But in the current situation, where we are experiencing uneven milk production increases fueled largely by low feed prices, such cuts would greatly increase instability in the industry.

Thus, we will examine the long-term viability of the Commission's price recommendations, but in the short-term the Federation believes it is very important that the Secretary of Agriculture use his authority for a voluntary supply management program to reduce milk production and cut federal dairy program costs.

Beyond the Commission's recommendations on the dairy price support program, there are also numerous recommendations which, if adopted, would vastly improve the well-being of the nation's dairy farmers. Without examining each area in detail, the report is consistent with much of the Federation's policies with respect to federal milk marketing orders, the consolidation of the industry's national advertising and promotion efforts, food safety and animal health concerns, and the impact of technological developments on the industry's future.

I urge the Committee to pay particular attention to the report's recommendations on international trade and the potential impact of the General Agreement on Tariffs and Trade (GATT) negotiations now underway in Geneva. The nation's dairy industry is vitally concerned over the potentially devastating impact of a GATT agreement which would increase imports of dairy products and cripple our efforts to achieve a domestic supply-demand balance.

Specifically, I want to draw the Committee's attention to the Commission's recommendations on Section 22 of the Agricultural Adjustment Act. The report says:

> "The quotas established under Section 22 should not be renegotiated in future GATT negotiations. Just as the Commission strongly supports the milk price support program, it also strongly supports the Section 22 quotas for dairy products -- the two are tightly linked. Section 22 authorities, effectively applied, prevent interference with the effective working of the milk price support program. These quotas should not be renegotiated in the current GATT talks."

In closing, let me say that I hope this Committee will closely examine the recommendations contained in the report of the National Commission on Dairy Policy. In doing so, I believe you will find that the report, on balance, contains many important suggestions for the nation's dairy policy. To be sure, none of us will agree with every recommendation in the report. But let us use those differences to focus our collective efforts to mold a better future for the nation's dairy farmers. In doing so, we can assure that this great and productive industry will continue to provide the nation's consumers with a high quality product at very reasonable prices.

Thank you for this opportunity to provide the Federation's views on the Commission's report. I would be happy to respond to any questions.

Senator **Melcher**. Thank you, Tom.
Irv Elkin.

STATEMENT OF IRVIN J. ELKIN, PRESIDENT, ASSOCIATED MILK PRODUCERS, INC., AMERY, WI

Mr. **Elkin**. Thank you, Mr. Chairman. I am Irv Elkin, a dairy farmer from Amery, Wisconsin. I am also president of Associated Milk Producers, Inc., a dairy cooperative headquartered in San Antonio, Texas.

It was also my privilege to serve on the National Commission on Dairy Policy. The Commission's report represents, in my judgment, a workable outline for the future direction of dairy policy in the United States.

In the limited time available, I would like to direct my comments toward the two-tier pricing program recommended as one of two supply management options to be available to the Secretary.

The Commission recommends that standby production adjustment authority be used to assist in maintaining the needed supply-demand balance when production is building toward excessive levels. This is based on a very simple concept—the time to deal with surpluses is before they occur.

The two-tier price program has the advantage of involving all producers in addressing the issue. It avoids regional "tilts" and the prospect of large payments to individual producers which have been the subject of recent publicity. There is a pay-in by some dairy farmers, rather than a payout by Government.

The two-tier program would be voluntary in that the individual producer would make the decision as to the production levels on his or her farm; full participation in that it would involve all producers either through reducing production to reflect market needs or by contributing toward funding Commodity Credit Corporation purchases resulting from their individual excess production.

The two-tier program would be used when: forecast milk supplies are greater than Government program needs plus a reasonable market reserve. When the two-tier program is in effect, dairy farmers would be responsible for dairy price support program costs associated with CCC purchases in excess of the trigger level. If the forecast is below the trigger level, the two-tier program would not be used. If the program had been in effect during the current year, it would end.

PROGRAM MECHANISM

The operating mechanism of the program is the price the farmer receives for milk. When the two-tier program is in effect, a producer would receive two prices for milk. The full market price would be received for that portion of the milk needed to meet commercial market needs and the market reserve. A much reduced price would be received for marketings in excess of market needs and this reserve.

The person paying the farmer for milk would monitor marketings against his or her marketing history. Producers reducing marketings to market needs would receive the full price on all milk. Those marketing in excess of market needs would have the price on the excess reduced by an amount the Secretary of Agriculture determines sufficient to meet producer responsibility for program costs. The money represented by this reduction in price would be remitted to the Commodity Credit Corporation.

It is anticipated that the required production reduction would be relatively small. The concept is to have the program put into operation before a substantial surplus buildup has taken place.

THE MARKETING HISTORY

Many program features would have to be dealt with in the development of this or any supply management program. A major concern of many producers is establishment of the marketing history.

SUMMARY

In summary, the two-tier program is market oriented: All income is received from the market; Government payments are avoided; production decisions are based on market price signals.

It maintains farm income. It provides farmers with tools to assist them in tailoring production to the needs of the market; it allows the individual farmer to determine production levels on his or her farm.

It controls Government costs: It places a cap on the cost of the Dairy Price Support Program; it places the burden of increased program costs on those increasing production when not needed for the commercial market.

It is simple: No program signup is required; no contract compliance or accounting for livestock movement or sales is needed; early implementation avoids potential impact on livestock markets.

It provides an effective standby supply balancing mechanism: The program would not be used when supply-demand balance is achieved; finally—and this is what the report was all about—I believe it would remove the uncertainty surrounding dairy policy and allow producers to more efficiently plan their operations.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Elkin follows:]

Statement of

ASSOCIATED MILK PRODUCERS, INC.

Before the

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

UNITED STATES SENATE

With respect to

United States Dairy Policy
and the
Report of the National Commission on Dairy Policy

April 28, 1988

Irvin J. Elkin, President
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I am Irvin J. Elkin, a dairy farmer from Amery, Wisconsin. I am also President of Associated Milk Producers, Inc., a dairy cooperative marketing association owned by more than 22,000 dairy farmers in 21 states across the Upper Midwest, Central and Southwest United States. Headquartered in San Antonio, Texas, the cooperative's operations range from marketing bulk fluid milk to the production and marketing of a wide range of manufactured dairy products.

It was my privilege to serve on the National Commission on Dairy Policy which Congress directed be established as part of the Food Security Act of 1985. The Commission's report represents, in my judgment, a workable outline for the future direction of dairy policy in the United States. It recognizes the need for change in the direction of policy where change will serve to improve the performance of markets and improve opportunities for producers while continuing to assure consumers an adequate supply of milk at reasonable prices.

Addressing the area of price support policy alone, the report's findings can be summarized as follows:

1. The purchase type program continues as a sound, workable basis for any dairy program.
2. An effective formula taking into account the effect of technology, conditions in other sectors of agriculture and the general economy, changes in consumer purchasing power, and the supply and demand for milk should be used to determine the support level.
3. Standby authority is needed directing the Secretary of Agriculture to implement production adjustment--supply management--operations in the event that excess production capacity is developing.

The Commission's report is the product of months of work assessing current and past program operations. We heard testimony from dairy farmers, marketing experts, academicians, and other spokespersons across the country. A range of policy options was examined. The report is a product of that process. Any single member of the Commission would very likely have written a different report. Eighteen dairy farmers from widely varying backgrounds from every production region of the country will have greatly differing views. I believe there were many who expected the Commission would not be able to develop a unified position. It was possible only because Commission members were willing to address the issues on the basis of what will best serve the industry nationally. The product is, I believe, worthy of your support and implementation.

In the limited time available, I would like to direct my comments toward the two-tier pricing program recommended as one of two supply management options to be available to the Secretary.

As indicated, the Commission recommends that standby production adjustment authority be used to assist in maintaining the needed supply-demand balance when production is building toward excessive levels. This is based on a very simple concept--the time to deal with large surpluses is before they occur. It is easier, more cost effective and more efficient from every standpoint to do this than to allow development of such excess capacity and then, by whatever means, implement programs or actions designed to remove the required resources from milk production.

The two-tier price program is one that will work quite well in this respect. It has the advantage of involving all producers in addressing the issue. It avoids regional "tilts" that we have seen where heavy participation in a region could result in excessively shortened milk supplies. It avoids the prospect of large payments to individual producers which have been the subject of recent publicity.

The Concept

The Two-Tier Program would operate as part of standby supply management authority under which the Secretary of Agriculture would be required to assist dairy farmers in adjusting production anticipated output exceeds market needs plus a reasonable reserve.

It is designed to:

... Improve and maintain dairy farmer income.

... Maintain an acceptable supply/demand balance.

... Place a cap or limit on government costs.

... Assure adequate supplies of U.S. produced milk at reasonable prices.

The Two-Tier Program would be:

... VOLUNTARY in that the individual producer would make the decision as to production levels on the farm.

... FULL PARTICIPATION in that it would involve all producers either through reducing production to reflect market needs or by contributing toward funding Commodity Credit Corporation purchases resulting from their excess production.

The price support level would be determined using a formula which reflects costs faced by farmers in the production of milk and living costs, changes in technology and conditions in the rest of agriculture and the general economy.

The Two-Tier Program would be used when:

- ... Forecast milk supplies are greater than government program needs plus a reasonable market reserve.
  - ... Prior to the beginning of the marketing year, the Secretary of Agriculture would announce the support level and estimate the level of production and commercial demand for the year.
  - ... If this forecast anticipates CCC purchases in excess of the trigger level, the Secretary would implement the Two-Tier Program.
- ... When the Two-Tier Program is in effect, dairy farmers would be responsible for Dairy Price Support Program costs associated with CCC purchases in excess of the trigger level.
- ... If the forecast is below the trigger level, the Two-Tier Program would not be used. If the program had been in effect during the current year, it would end.

Program Mechanism

The operating mechanism of the program is the price the farmer receives for milk. When the Two-Tier Program is in effect, a producer would receive two prices for milk.

- ... The full market price would be received for that portion of the milk needed to meet commercial market needs and the market reserve.
- ... A reduced price would be received for marketings in excess of market needs and reserve.

The person paying the farmer for milk would monitor marketings against the marketing history. Producers reducing marketings to market needs would receive the full price on all milk. Those marketing in excess of market needs would have the price on the excess reduced by an amount the Secretary of Agriculture determines sufficient to meet producer responsibility for program costs. The money represented by this reduction in price would be remitted to the Commodity Credit Corporation.

It is anticipated that the required production reduction would be relatively small. The concept is to have the program put into operation before a substantial surplus build-up has taken place.

Program Implementation

The following steps would be involved in putting the program in place.

- ... Announcement of the price support level and the need to use the Two-Tier Program would be made prior to the beginning of the marketing year.

... All producers would have marketing histories established. If reductions are required, they would be applied uniformly to each producer's history.

... The Secretary would announce the price reduction to be applied to excess marketings.

... The government responsibility for CCC purchases would be increased by the amount of any temporary or permanent expansion of dairy product import quotas.

... The Secretary could increase allowed marketings or end the program entirely during the marketing year if necessary to assure an adequate supply of milk nationally.

... A year-end reconciliation would be available to any producer who had price reductions made in one month offset by later marketing reductions.

The Marketing History

Many program features would have to be dealt with in the development of this or any supply management program. A major concern of many producers is establishment of the marketing history. There are a wide range of possibilities in this area. The following are some of the considerations that have been discussed.

... Use of a recent period to establish the history. For example, the producer could be given the option of using the most recent 12 month period or the average of the two most recent 12 month periods.

This would allow the marketing histories to reflect the current situation in the industry.

... No adjustments would be allowed in the marketing history. Use of a recent period with an option to choose as outlined above should reduce the need for adjustment. Further, since a new history would be established each time the program is implemented following a break, the need for adjustment would be less.

... Producers who reduced marketings under an earlier Two-Tier Program would have their histories adjusted to reflect that participation.

... New producers would have a history assigned equal to 75 percent of their daily average deliveries annualized.

Summary

The Two-Tier Program:

- ... Is market oriented.
    - ... All income is received from the market.
    - ... Government payments are avoided.
    - ... Production decisions are based on market price signals.
- ... Maintains farm income.
    - ... Provides farmers with tools to assist them in tailoring production to the needs of the market.
    - ... Allows the individual farmer to determine production levels on the farm.
- ... Controls government costs.
    - ... Places a cap on the cost of the Dairy Price Support Program.
    - ... Places the burden of increased program costs on those increasing production.
- ... Is simple.
    - ... No program signup is required.
    - ... No contract compliance or accounting for livestock movement or sales is needed.
    - ... Early implementation avoids potential impact on livestock markets.
- ... Provides an effective standby supply balancing mechanism.
    - ... Program would not be used when supply/demand balance is achieved.
    - ... Would remove the uncertainty surrounding dairy policy and allow producers to more efficiently plan their operations.

Senator **MELCHER**. Mr. Tipton.

STATEMENT OF E. LINWOOD TIPTON, PRESIDENT, MILK INDUSTRY FOUNDATION AND INTERNATIONAL ICE CREAM ASSOCIATION, WASHINGTON, DC

Mr. **TIPTON**. Thank you, Mr. Chairman. I appreciate the opportunity to appear before the committee this morning. On behalf of processors, the Milk Industry Foundation and the International Association of Ice Cream Manufacturers represent the users of about 70 percent of the milk supply in the United States. And we appreciate the opportunity to appear.

The **CHAIRMAN**. Tip, why don't you just bring the microphone a little bit closer in there.

Mr. **TIPTON**. I particularly appreciated the comments of Chairman Leahy, particularly the last paragraph in his opening comments, indicating that he wanted to set a stage for dialog.

And that is where we believe the report is going to be extremely helpful. We want to commend the Commission, each of the members of the Commission, for their work on the report. Obviously, they spent long hours; gave it thoughtful consideration; and we think they made a very substantial contribution to establishing dairy policy in the United States.

We would also like to commend the Commission staff. They obviously brought a very professional and hard, solid look analytically, at the information that was being developed. So we are very pleased, in fact, with the Commission's report.

Getting to some of the specific provisions of the report, we were particularly pleased with the provisions dealing with market orientation, and recommending that price be the primary determinant of maintaining a balance of supply and demand in the United States.

That is a position we have felt has been the direction dairy policy should be taking for a long period of time, and is the position that is embodied in the 1985 farm bill, after having gone through a period of a couple of other elements that the Commission has also recommended be in the standby position.

But the basic position of the 1985 farm bill was that supply and demand should be balanced by price. And we commend them for that recommendation.

We think that the other elements of the report dealing with the family farm and regionalization are extremely helpful and commend them for those recommendations as well.

The area of the report that we have severe reservations about are the two areas dealing with the standby authorities. The whole herd buyout is one, and the two-tier program being the other, as Mr. Elkin has just described.

In our opinion, the diversion program and the whole herd buyout program, that have already been tried, have introduced rather severe distortions.

It is interesting to me that an awful lot of people, I think, are not aware of the fact that both of those programs, when they were implemented, resulted in domestic prices, the prices farmers were receiving for milk, increasing very substantially during a period when the CCC was also acquiring very large stocks of product.

They introduced a distortion, a regional distortion, that drove prices up, while at the same time, the effort was being made to try to actually reduce the support price and thereby discourage production.

The two-tier pricing program, I do not think it is often identified as a quota program. But in fact the two-tier pricing program would impose quotas in order to establish what the base price would be and what the overprice would be.

And we think that that is the wrong direction.

I suppose one of the major criticisms of either of those programs is, how do you get out of them? Particularly, I think, the two-tier pricing program, once you implement that and allocate some quotas, it becomes very difficult to extricate yourself.

So it no longer becomes a standby program, but becomes a program that is the primary policy tool for the price support program.

Mr. Chairman, I would like to identify some of the provisions that are not in the report, actually, but the provisions that an advisory committee that we have constituted have given us.

We appointed an advisory committee consisting of member company executives from dairies throughout the United States, representing large and small—all sizes—and they gave us six different provisions. In closing, I would like to just reiterate what those are.

One, I want to say that we wholeheartedly support the price support program and the Federal milk marketing order program, and want to maintain those programs. That does not say that we do not think some changes, particularly in the marketing order program, might be warranted at some point, but in terms of the basic programs, we support those and want them maintained.

Two, the objective of the price support program should be to maintain a reasonable supply-demand balance through the use of the price support adjustments; and that is in accordance with what the Commission has recommended.

Three CCC purchases should be maintained at between 2 and 5 billion pounds annually. This is slightly different from the Commission's report, but basically in line with what the Commission has recommended.

Four, the Government should not reduce the reserves of CCC-held dairy products through special foreign sales and donations, or through special domestic feeding programs to such an extent as to cause an increase in domestic prices of milk. We are fearful that with the current disposing of CCC stocks, there may be a run-up in the prices of dairy products this fall, largely caused by the fact that we have given away and otherwise subsidized the disposal of those stocks.

Five, the food assistance program should be designed to operate independent of and not interfere with commercial markets. And that is primarily designed at the programs of giving away cheese and butter and so forth on previous occasions when they displaced substantial amounts of commercial sales.

Six, no program should be based on quotas, production bases, diversion payments, or producer assessments.

Mr. Chairman, I thank you very much for the opportunity to testify. I would make one other comment, and that is, there has been quite a bit of conversation about the increase in sales. And we think that that is, actually, the future solution to the dairy program.

We think that the combination of maintaining a reasonable price to get the production, and the advertising programs, will be very helpful in doing that.

Sales have gone up drastically, and we think that is the easy way out of the problem.

Thank you.

[The prepared statement of Mr. Tipton follows:]

STATEMENT

OF THE

MILK INDUSTRY FOUNDATION

AND

INTERNATIONAL ICE CREAM ASSOCIATION

PRESENTED TO

THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

OF THE

UNITED STATES SENATE

APRIL 28, 1988

888 16th Street, NW
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E. Linwood Tipton
President

My name is Linwood Tipton and I am President of the Milk Industry Foundation (MIF) and the International Ice Cream Association (IICA). The milk and ice cream associations are national trade associations representing fluid milk processors and ice cream manufacturers in all 50 states. Together our member companies own and operate plants that process and distribute an estimated 80 to 85 percent of all the fluid milk and ice cream products manufactured in the United States. The milk and ice cream industries we represent use approximately 70 percent of the nations milk supply.

We appreciate the opportunity to appear before this Committee to offer a processor perspective on the report and recommendations of the National Commission on Dairy Policy.

At the outset we must commend each of the 18 commissioners for the many hours of hard work, effort, and thoughtful consideration that went into their final report. We also must commend the Commission staff who were thorough and professional.

We were pleased to have had an opportunity to appear at the very first public hearing held by the Commission more than a year ago. In subsequent hearings held around the country, more than 250 dairy farmers, processors, economists, and other dairy leaders testified. It was clear to us that the Commission was prepared to set aside regional differences and biases and do what they believe to be in the best interest of the nation and the dairy industry.

We were very encouraged that the Dairy Commission recommended that dairy policy should be market-oriented and that price adjustments should be the principal mechanism to ensure a balance between milk supply and demand. This is an approach that we as processors have advocated for some time. We are strong supporters of the price support program and believe that a market-oriented program can best serve the needs of the industry and the nation.

We believe the Commission's discussion of attempting to develop a dairy price support program based on the undefinable term "family farm" and its appraisal of a regional quota system are correct. Neither of these approaches provides an appropriate basis for establishing dairy price support policy. Any effort to "regionalize" the support program must reflect the actual value of dairy products in those regions.

We concur with the Commission's conclusion that federal programs should not attempt to give preferential treatment to producers and processors in one part of the country over another. This would interfere with natural competitive factors already in place and lead to economic distortions as to where milk should or should not be produced.

While we support many of the Commission's recommendations, we must also take strong exception to their recommendation to adopt standby supply management programs, whether it is in the form of another herd buyout program or a two-tier pricing system.

Our experience has been that any short-term reduction in milk production that might be gained by such programs is far outweighed by the economic distortions and market disruptions that such programs create. The paid diversion and whole-herd buyout programs we had in 1984-85 and 1986-87, respectively, are good examples not to follow. Even though 38,000 farmers signed up for the 15 month paid diversion program, milk production quickly soared when the program ended and many argued that the program was not long enough. Similarly, as soon as the 18-month dairy termination program ended, milk production again started to increase. And now some are arguing that we need another buyout. These types of programs are short-term at best. In both cases these programs caused raw milk prices to increase significantly at the same time that surplus purchases by the Commodity Credit Corporation (CCC) indicated a need to reduce the price support. In the fall of 1986, for instance, the Minnesota-Wisconsin price for raw milk increased from or $10.98 per cwt. level in May (which was 33 cents below the $11.31 support price at that time), to $11.91 per cwt. in November. This was nearly a $1.00 increase and in large part due to the effects of the whole-herd buyout program.

In fact, while the price support was reduced by $1.00 per cwt. from $11.60 in 1986 to $10.60 today, the average wholesale milk price received by farmers this past January was only $.02 below the average price received by farmers in 1986. And in March, the most recent data available, the wholesale milk price was $12.00 per cwt., only $.52 below the price received by farmers in 1986. This too can largely be attributed to the effects of the whole-herd buyout program.

Similarly, many fluid processors in the northeast are paying over order premiums for the first time to attract milk for bottling purposes even though the CCC will likely purchase in excess of 8.0 billion pounds of surplus milk in 1988. This situation is also largely attributable to the effects of the whole-herd buyout program. Diversion programs and buyout programs are not long term solutions to the dairy surplus problem.

The Commission correctly acknowledges that use of production controls on a permanent basis is not in the best interest of the industry. We would argue that even temporary production control programs are not in the best interests of the dairy industry. Temporary programs often become the rule and not the exception. Price support adjustments we feel are the only effective long term solution to the dairy surplus problem. Once a quota or base program is started it is very difficult to discontinue it.

The Commission also recommended that an economic formula be established in law to determine the price support level for milk. Even though the Commission recommends that a "forward-looking" formula be used, past experience with pricing formulas indicates that it is difficult if not impossible to develop a forward-looking price that makes economic sense when it is based on historical data.

The dairy industry is changing rapidly and will continue to undergo dramatic changes in the years ahead. The price support program has worked best when the Secretary of Agriculture has had sufficient discretion to adjust the support price based on market conditions. We seriously question the need for an economic formula to establish the support price level. If CCC purchases are in excess of 5 billion pounds, it seems clear that the support price is still too high and should be reduced.

MIF and IICA will continue to be active participants in the dairy policy arena. In preparation for future policy discussions, we recently convened a Dairy Policy Advisory Committee consisting of executives from both large and small dairy companies from across the country. This committee, recommended and our Boards of Directors recently adopted, the following guidelines with respect to dairy policy:

1. MIF and IICA support continuation of the dairy price support program and the Federal Milk Marketing Order program.

2. The objective of the price support program should be to maintain a reasonable supply/demand balance through the use of price support adjustments.

3. CCC purchases should be maintained at between 2 and 5 billion pounds annually.

4. The government should not reduce the reserves of CCC held dairy products through special foreign sales and donations or through special domestic feeding programs to such an extent as to cause an increase in domestic prices of milk.

5. Food assistance programs should be designed to operate independent of and not interfere with commercial markets.

6. No program should be based on quotas, production bases, diversion payments, or producer assessments.

These guidelines we feel will maintain an adequate supply of pure and wholesome milk while bringing a better balance between milk production and demand. In addition, we feel that these guidelines offer a market-oriented program that will maintain stability for producers and consumers and help keep a lid on government costs.

The 1985 Farm Bill started us in the right direction and we must continue to build on that. The big dairy success story of the mid 1980's has been the tremendous increase in dairy product sales, both in absolute terms (12.7 billion pounds between 1983 and 1987) and on a percentage basis (a 9.2% increase during the same period). These are the largest increases in recent memory. While there may be some debate as to whether advertising and promotion or prices and income have played the larger role in this tremendous growth, it is clear that stable retail dairy product prices over the past few years have had a very positive impact on dairy product sales.

If we can maintain a market-oriented dairy policy, dairy products will remain competitive and we can continue this positive trend.

Mr. Chairman, thank you for the opportunity to appear today. I would be delighted to respond to any questions that the Committee may have.

The **Chairman**. I was just curious on one thing. In reading over your testimony, Mr. Camerlo, have you done work, or has the National Milk done work, or can you point to the Northeast or the Midwest or the Southeast or the Southwest, or whatever and say, at *x* dollars per hundredweight, they will stop producing milk?

Are there such studies?

Mr. **Camerlo**. Mr. Chairman, I would like to call on Mr. Barr to give you the details. But let me tell you how, as a farmer, I see it.

The problem is in our area of the country, and I think in most areas of the country, a dairy farmer loves the soil, wants to be in this business, and intends to stay there.

He will borrow every dime he can get to stay in business. And as we lower prices, the first thing he will do is produce more milk to meet the cash-flow.

And so you say, at what point does he stop? You have got to go, at what point will the bank stop giving him money to stay in business and foreclose?

So with that as an overall——

The **Chairman**. Another flip on that, and probably to give the most accurate answer to it, at what price does it make sense for somebody to go into dairy farming? Which may actually give a more realistic price on it.

Did you want to comment?

Mr. **Barr**. Well, Mr. Chairman, I would just say, that is very much an individual statistic, depending on the individual farmer and what his costs of production are in relationship to the price of milk.

The **Chairman**. So you do not have a study?

Mr. **Barr**. No, sir, we do not.

The **Chairman**. We know that there are general differences, as I understand, among parts of the country, everything from your topography, the types of farms, and everything else. Is that correct?

Mr. **Barr**. Yes. The point I was going to make is, that right now in certain parts of the country, where producers tend to purchase most of their feed as opposed to growing their feed, they are able to take advantage right now of extremely low feed grade prices.

And I think that is one of the reasons——

The **Chairman**. That is not going to last.

Mr. **Barr**. That is not going to last, that is right. That is one of the reasons you see production increasing so rapidly in certain parts of the country as compared to others.

The **Chairman**. I agree with Mr. Camerlo, the time to control production is simply by lowering the price. Certainly it is not workable in the short term, but I am convinced it is workable in the long run. Because if you have got somebody out there who still has the mortgage to pay, the electricity still costs the same, taxes are about the same, equipment costs, and payment on the equipment costs, are the same.

Well, then, everything else is finite. One way you get more money is to produce more milk.

Senator Melcher.

Senator **Melcher**. Well, there have been several comments about social programs, and I guess we have been sort of zeroing in on family farmers. But I want to look at it from the other side.

I think a good dairy program is pretty important both as a social program and as a practical program for the consumers.

Now, just enlighten me, a quart of milk, or whatever quantity you want to give it, a half gallon or whatever, purchased in a supermarket here, would compare to how much it cost for food and milk in the same quantity in Europe? Do any of you know?

Mr. CAMERLO. Let me take a shot at that. The last time, a couple of years ago, when I had an opportunity, and this was before the change in the dollar, Senator, it was about twice the price in Paris as compared to Denver, Colorado.

Now, I don't know whether that is——

Senator MELCHER. Anyway it is substantially higher. Whether it is twice as much or whatever, it is substantially higher in Europe.

Mr. BARR. I would say so, yes.

Senator MELCHER. We can always produce more milk, just as we can produce more chickens or eggs or beef or pork in this country. We are always tending to overproduce. That is why I was interested in what the Commission said on exports.

It was not a big section but it was not anything I would disagree with. Do any of you have the answer to a question I posed to the preceding panel on what the rule of thumb is on how much grain you put into producing a pound of milk, a pound of dried milk, is it about 1½ to 2 pounds of grain? What do you feed your cows, Tom?

Mr. CAMERLO. I feed 30 pounds of concentrate for a herd average of 85 to 100 pounds. So 2½ to 3 pounds of milk to a pound of feed.

Senator MELCHER. When they are producing you put in 30 pounds a day?

Mr. CAMERLO. Yes, 30 pounds of concentrate. So it would be about 2½ to 3 pounds of milk from a pound of concentrate.

Senator MELCHER. Of concentrate? Well, as a practical matter, I wondered why we do not export more dried milk or cheese or something, and that takes care of part of the grain surplus.

Is that a practical thing to say? It would have to be supported, of course, under existing conditions. I realize that. But we are subsidizing these grain sales pretty heavy.

Mr. CAMERLO. There are two things that seem to me. One, yes, I think it is practical, and I think it is worthwhile. Also, I am a dairy farmer, so I would think that, Senator.

But the other thing is, we are in the ballpark now with this dairy export incentive program. This has got us out there in the field.

Senator MELCHER. It has?

Mr. CAMERLO. I think it has.

Senator MELCHER. Have you heard of any recent shipments? I would be delighted to hear of one. Has there been one?

Mr. BARR. Well, I was just going to say, Mr. Chairman, your amendment in the 1985 farm bill certainly gave the opportunity to participate in that program.

Unfortunately, there has not been a great deal of product shipped, as you well know.

Senator MELCHER. I really do not know how much has been shipped. I guess there has been some sales under it, but it has been pretty limited.

Regarding the dairy herd buyout, that is not very likely to become law again very quickly, I hope. It raised havoc with the beef market. However, some of those cows were sold abroad. Does anyone know how much they had to subsidize those sales?

Mr. BARR. About 50 percent I believe.

Senator MELCHER. About 50 percent? Well, of course, that is true market development. I happened to be at the same table with some Indonesians last Saturday night, and they remarked about that, how much they need it.

Of course they need so much. I do not think they have much of a dairy industry there for over 160 million population.

Mr. BARR. No, but as you know, some of those cows did go to Indonesia.

Senator MELCHER. I do know that. I knew it at the time, and my dining partner commented on it then, and it was very much appreciated; very necessary. I was glad to get that input. Irv, do you feed 30 pounds? Do you feed that much?

Mr. ELKIN. Yes. That's a good rough number.

Senator MELCHER. That is what you do? Your give a milk cow 30 pounds everyday.

Mr. ELKIN. That's right. And of course if you want to convert that, you know, then she also receives roughage. If you wanted to convert that to grain equivalent, it would be higher.

Could I say something else, Senator? The flip side—and you have asked the two panels how much grain we could export with each 100 pounds or pound of nonfat. The flip side of that is, how much grain do imports of dairy products displace?

That is why we have so much concern about import levels. If we have imports coming in, they displace an equal amount of what you are talking about exports moving. They also put some of us out of business.

Senator MELCHER. I completely agree with the testimony on your views. I guess the Commission views sort of parallel it on casein, and other dairy product imports; they ought to be subject to section 22. I do not know why they are not.

But we do import, in effect, grain, if you want to call it that, any time we buy casein or any other dairy product.

Well, thank you all very much.

The CHAIRMAN. Can I just ask Mr. Tipton a question. If purchasers were down to 2½ pounds, we might not have products for school lunches. If that happened, would you support a commercial purchase program for school lunches?

Mr. TIPTON. Yes, we have not been opposed to that at all. The 2½ billion pounds, as you know, under the recommendations and under our proposal would constitute a raising of the support price at that point.

But we would support that to be done through commercial channels; very much so.

The CHAIRMAN. Well, I appreciate all of you being here. I am sorry I had to step out during part of the hearing.

There has been some talk about some aspects of this having a parochial flavor to it. That would never happen by any of us in the Senate Agriculture Committee, the one committee along with the

Appropriations Committee, that eschews any parochialism of course.

But along with that we had a meeting with the Prime Minister of Canada, and we had a couple of matters that involved some border problems between Vermont and Canada and of course some acid rain questions.

So I was tugged between two places. But I want to thank Senator Melcher, Senator Daschle, and others who filled in to help chair this hearing.

Trust me, everything you have said here is going to be really gone over, not only by me, but by everyone on the staff, with a fine tooth comb. The issue that we are raising here is one of great interest to me.

I consider this as sort of a preliminary hearing prior to the one on May 11. Then, of course, we will be reconsidering a lot of these issues in the farm bill, along with a few issues out your way, I suspect. You have got a few issues that have more than a passing interest in the 1990 farm bill.

Senator MELCHER. Absolutely. The chairman is absolutely correct that no one is parochial on this committee; we are all very evenhanded.

The CHAIRMAN. Sometimes more evenhanded than others.

The statements of Vermont State Representative Andrew Christiansen and Representative Jean Anne Duffy will be included into the record.

[The prepared statements of Representatives Andrew Christiansen and Jean Anne Duffy follow:]

Analysis of the National Commission on Dairy Policy Report

Statement by
Vermont State Representative Andrew Christiansen
Clerk of the House Agriculture Committee
April 28, 1988

It was a month ago that the Report and Recommendations of the National Commission on Dairy Policy was released. While a great deal of effort was put into the study and some positive recommendations were made, there appear to be some serious flaws in both the method and the conclusions of the report.

First, there appears to be a bias amongst the majority of Commissioners against supply management and other alternative proposals and a predisposition towards a policy which ended up being the final recommendations of the Commission. Most of the time, the impressions for witnesses that what they were saying was not the desired testimony were subtle, but at times the prejudice of a Commissioner was made more obvious.

Quotes such as "what we would hope here is that this is truly a market-oriented program"[p.B16] or "As an established dairyman, I - wouldn't we probably be very much in favor of the supply management because we're established and we establish an equity all of a sudden and you're talking about the Canadian situation where you know, all of a sudden you're worth a couple hundred grand more?" The witness answered that his farm was suddenly "worth quite a few grand less" and explained that there were

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ways to limit the value on quota. The exchange got more animated as another Commissioner jumped in to say that he had a hard time with the attitude of having a price on the quota..."It's going to have a value whether it's paid out front or behind the barn or under the table." to which the witness replied "If you chose to be a plumber could you go out and plumb without a license?" The exchange continues for awhile and finishes with the Commissioner saying "I was just wondering why you feel it's the Canadian syndrome of their quote system with the exorbitant prices. I don't particularly like the Canadian system that everybody is so concerned about the price or quotas or bases."[p.B-19]

Throughout the transcripts of the hearings there is generally more praise given to those giving the "correct" view of things, which contained references to the "free market" which emphasizes "comparable advantage" and "rewards" to those farmers who by being "market oriented" are more "efficient, innovative and industrious." Witnesses with an alternative view were more often challenged and forced to defend their views. This subtle pressure is not conducive to an objective investigation. While the Commission claimed to have practiced "sunshine government" with open meetings, the final report suggests that sun glasses must have been in abundance.

Having looked at the testimony of 100 witnesses (from the hearings in California, Wisconsin and New York) and found that 66% of those farmers, who expressed an opinion as to a preferred policy, favored supply management and 59.3% felt that a regional policy or regional considerations were important, it would seem that the warning of one of the farmers at the hearing in Hudson, Wisconsin was important. He said "I realize that a number of Senators and Congressmen are waiting to see this report of these hearings and I hope the reports of the same are accurate to what the hearings have transformed." It would seem that the testimony of the Coops, processors and academicians were considered to be more important than what the farmers had to say. It is an insult to those farmers, whose throats will be cut by this policy, to have the Chairman of the Commission say "Our plan is realistic and enjoys broad support within the dairy industry." The fact that it was paid for through CCC funds and that not one of the eighteen commissioners was a woman makes the final product smell even worse.

The second concern in studying the final report is the schizophrenic nature of the recommendations. As soon as one point is made or a philosophy expressed it is immediately contradicted. For example, the report calls for "minimal government intrusion in agriculture" (p.8) and for a "free market (where) supply and demand are balanced through price adjustments."[p.60] References to free market, comparable advantage and the elimination of any farmer who is not fortunate enough to be in a low-cost producing area are to be found on pages 55,58,60,78,85,92,94,100,128, and 132. I only mention these page numbers, because the report also launches an attack against the operation of a free market on two fronts.

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First, on pages 21 through 22 of the report, evidence is presented to demonstrate that the price received by the farmer has nothing to do with the price in the store. It concludes, "In the context of agricultural policy debate in the 1980s, a critical assumption was that reduced farm prices would be passed through as lower consumer prices. Yet, milk producers should have realized more direct benefits from the very significant increases in consumption that could have resulted from these price decreases." The Commission report doesn't make any attempt to explain this phenomena. It seems momentarily puzzled by it, then happily goes along suggesting the same old policies without any attempt at critical analysis. For those who are interested, one article that documents this more fully can be found in the May 1987 American Journal of Agricultural Economics, "Asymmetry in Farm-Retail Price Transmission for Major Dairy Products", Henry W. Kinnucan and Olan D. Forker.

Second, a case is made for a protectionist policy in respect to the General Agreement on Tariffs and Trade (GATT)[p.133-134] and import quotas for casein is recommended [p.135]. If a free market and comparable advantage are so sacred in the domestic market, why not go for a free world market. Even if the other countries gave up their subsidies, the Commission would still ask for studies to be done to see if a free market would be good for American producers for 1, 5, and 10 years. While I would personally feel more comfortable with this cautious approach, it is philosophically inconsistent. One can't have it both ways.

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Another weakness in the report is the lack of careful and thorough analysis. On page 9, the report states: "Don't use price supports to accomplish social goals... The trend toward fewer, larger farms began decades ago and will continue under any farm policy or program. Social goals, such as maintaining a maximum number of farms, are accomplished better through transfer payments or tax code changes than through changes in price supports."(emphasis added) While the recommendation is strongly made, there is no evidence presented, no review of the economic literature provided to support this claim.

In fact, a review of recent articles in economic journals would suggest quite the opposite. First, it is evident that while Europe has faced the same development of biotechnology, mechanization, and problem of surpluses, they have fashioned a policy of supporting milk prices in order to retain a larger number of their farms. This is due in part to the recognition of national security implications when food production is centralized.

Second, the idea that tax code changes is the best way to effect policy has been disputed. [See "Dynamic Analysis of Income Taxes on Farm Firms", American Journal of Agricultural Economics, May 1987 pp. 358 - 368, Hardesty, Sermin D., Carman, Hoy F., and Moore, Charles V.] The article, analyzing the 1981 Economic Recovery Tax Act, discovered that farmers' economic behavior was just the opposite of what was expected. "Because of interactions between tax provisions, the tax changes had the unexpected effect of reducing optimal investment in machinery and land." It also found that "progressive tax rates combined with deductible interest and depreciation will always provide a differential advantage to larger farm firms." [p.368]

Since this is what we have traditionally done in this country and what the Commission recommends doing more of, the Commission is once again guilty of promoting conflicting policies. Many times in the report, they say that producers should be treated equally [p.8 and elsewhere], but it would seem that they would target most benefits to the wealthiest farmers.

There are many more examples of contradictory statements and conclusions within the report, but I will focus on just one more.

On p.157 in the concluding words of the report, the Commission "realizes that USDA-sponsored programs for domestic and overseas distribution alleviate build-up of surplus stocks of dairy products while providing necessary food supplies to those currently unable to provide for themselves. Efforts by USDA to reduce the surplus through distribution programs are working, but USDA should establish programs that will not focus primarily on the distribution of surplus products, but instead, expand markets and profit-making capabilities of the dairy industry."(emphasis added)

What this seems to say is that the food programs to feed the hungry in this country have worked, so let's scrap them and sell the surplus products to those who can afford to pay for them.

Unlike Marie Antoinette, who suggested cake for the hungry, this report says to the hungry and the homeless, Go to Hell!

While the Chairman of this Commission stated on March 31, 1988 that he hoped that this report would not "gather dust on government shelves", he seems to be suggesting just such a fate for other government reports. On May 9, 1986, the USDA released a study which supported the current system of providing government commodities through existing programs. Compared to other options such as cash payments or letters of credit such as vouchers, it was discovered that the present system provided a greater food value. Concentrating on the National School Lunch Program, it said; "By using the large volume purchasing power of USDA, most policy officials have felt that depressed agricultural markets could be stabilized to the benefit of farmers. At the same time, bargain purchases could be made for the lunch program. Now, a major research effort has proved that this common sense approach is working.

"This system is also relied upon to provide surplus commodities for other distribution activities. Presently, cheese, butter, nonfat dry milk, rice and honey, held by USDA's Commodity Credit Corporation, are distributed free of charge to schools, needy households, charitable institutions, such as public hospitals and orphanages, food banks, and soup kitchens. This system is part of our emergency feeding activities."

This emergency food system is now being destroyed. Throughout the report the Commission stresses the need to get rid

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of the surplus, but is there one? On January 1st of this year, USDA cut the dairy support price by 50 cents a hundredweight because, they said, the 'surplus' of dairy products was over the 5 billion pound limit set by the 1985 Farm Bill. A month later, USDA announced that they were discontinuing the TEFAP commodity distribution program because, they said, there were no surplus dairy commodities left in government storage.

How can the USDA make two such contradictory statements? Simple. They just lie, or so it would seem, and these lies hurt both dairy farmers and low income citizens. In Vermont alone, 75,000, or over 10 percent of Vermonters have been served by this program annually.

In conclusion, I would recommend to the Senate Agriculture Committee that little time be wasted studying this report. It is philosophically immature, biased, and hopelessly schizophrenic in its recommendations and analysis. Instead, the Committee should investigate the Commodity Credit Corporation and try to ascertain whether there is indeed a surplus, and look at other policy options with an objective approach. Only this kind of effort will lead to policy that will be fair to all farmers in this country and make this great land secure.

Editor's Note:

These articles are retained in the committee's file:
May 1987 American Journal of Agricultural Economics, ''Asymmetry in Farm-Retail Price Transmission for Major Dairy Products,'' Henry W. Kinnucan and Olan D. Forker.
''Dynamic Analysis of Income Taxes on Farm Firms,'' American Journal of Agricultural Economics, May 1987 pp. 358-368, Hardesty, Sermin D., Carman, Hoy F., and Moore, Charles V.

STATEMENT OF REP. JEAN ANNE DUFFY, VICE CHAIRMAN HOUSE AGRICULTURE COMMITTEE, VERMONT HOUSE OF REPRESENTATIVES

Good morning.

This past fall, President Reagan issued an executive order declaring as a principle of federalism the promotion of state and regional policy initiatives. The order identifies the following as a "fundamental federalism principle":

> In most areas of governmental concern, the states uniquely possess the constitutional authority, the resources, and the competence to discern the sentiments of the people and to govern accordingly. In Thomas Jefferson's words, the states are "the most competent administrations for our domestic concerns and the surest bulwarks against anti-Republican tendencies."

While I might have my differences on other matters with the President, I wholeheartedly concur with his affirmation of the controlling principle of our system of government: That in all areas except those few in which there is an overriding national concern, the programs and principles for our country are determined by the states rather than policy dictates from Congress, and that federal policy for these matters is molded in response to the state initiatives.

With this understanding in mind, I wish to express my disappointment and frustration with the report and recommendations of the National Commission on Dairy Policy. The report's underlying thesis seems to be that the dairy industry should be defined as the interstate trade of milk and milk products, and as such is one of those areas of overriding national concern that requires a national policy, or one to which states must subordinate and conform their actions. In this light, the report declares: "State ... programs adversely affecting the working of the Federal Dairy Program should be eliminated."

Certainly the interstate trade in milk and milk products gives the dairy industry a national characteristic, and there is an undeniable need for a coherent national dairy policy. Nonetheless, I believe the dairy industry's national characteristic is subordinate to its regional and local character, and I draw this belief from the evidence I see every day in my home state of Vermont in the profound importance the dairy industry has for our way of life.

Dairy farms sculpt our landscape and our cultural make-up. Dairy farmers are important contributors to our community and political life. And, of course, dairy farming is a key component of our rural economic base. Agricultural production generates $600,000,000.00, or 8 percent of Vermont's gross national product, and dairying is the foundation of this agricultural economy. Thus, the dairy industry while presenting an issue of national concern, or the interstate supply of and trade in dairy products, more profoundly affects the character and way of life of a state or region.

That Vermont's essence is derived from the presence of a rural economy is by choice, and commitment which I would like to highlight. This year alone, the state legislature is developing a number of programs designed to boost the competitiveness of Vermont's farmers. These programs will cost upwards of $60,000,000.00, or more than 10 percent of the government's budget. They are diverse as well as numerous, including property tax abatement, loan guarantees, a dairy price supplement and a fund to purchase development rights. These programs truly reflect our commitment to promote and ensure the vitality of our state's agricultural economy.

Vermont is not unique in its commitment to preserving the dairy industry and a rural economy. In diverse form throughout our country, states and regions take different actions to promote their dairy industries. Consistent with the principles of federalism outlined in the President's Executive Order, federal dairy policy should recognize the local and regional nature of the industry, and be shaped by these local and regional initiatives rather than seek to defeat them. Indeed, federal dairy policy should promote rather than frustrate the efforts of localities to aid their dairy farmers.

As is often the case, this political issue of the proper relationship between the states and the federal government reduces to a question of money. Here, the question is one of farmer income. The report favors a national uniform pricing structure; I am here today to promote regional pricing that reflects the needs and desires of the diverse regions of the country.

Consistent with its national view of the dairy industry, the report rejects regional pricing in favor of a national price structure in which prices are lowered when necessary to reduce surplus production. The projections of the report may very well be correct: The demand for milk and processed products may indeed be satisfied if the larger dairy operators are left free to grow and combine in a national market.

Nonetheless, such an outcome will contradict the wishes of a region such as New England which is less concerned with "industry efficiency" in the guise of the promotion of big efficient producers than it is with the assurance of the preservation of a vital rural economy. A uniform pricing structure, formulated without regard to its effect on different regions would serve to drive out countless numbers of farmers. The demand for milk may very well be served, but the desire to have farmers as members of our communities may very well be profoundly frustrated.

Regional pricing, on the other hand, is responsive to local and regional initiatives to preserve the local and regional dairy industry, and should be the linchpin of federal dairy policy. Regional pricing would allow historic patterns of supply and demand for fluid milk to remain as the basis of the dairy industry, and still allow the marketplace to respond to the new market force of national demand for dairy products.

Before I conclude, I would like to mention two other specific problems I have with the report. Both address the problem of surplus production. We all must acknowledge that surplus production is an area of national concern. Why then does the report suggest waiting until the surplus increases from 5 to 7 billion pounds before taking action? Second, why does the report refuse to implement a program aimed at the producers who produce the surplus? Simply reducing the support price reduces supply but does not reduce the surplus production because a slightly reduced price has only minimal effect on the surplus producers.

Again, I suggest to you that even this issue of national concern is in reality one of a regional nature. Excessive production as consumer product travels little from region to region. Rather, most of the surplus production in one region affects other regions only through either a reduction in the support price or the expenditure of tax dollars to purchase the surplus product. If surplus production is considered in terms of its regional nature, or as that amount which is in excess of what is needed to ensure regional supply and regional competiton in the national market, then it readily becomes apparent that a regional solution can be devised for this problem as well.

We in Vermont, and our fellow states in our region, are determined to preserve our agricultural heritage. When faced with another challenge in another day, Ethan Allen declared:

> I am as determined to preserve the independence of Vermont as Congress is that of the Union, and rather than fail I will retire with my hardy Green Mountain Boys into the caverns of the mountains and make war on all mankind.

While we certainly do not have to pursue so radical a solution to the dairy crisis, we are firm in our resolve to do all that we can. We hope and expect our national government to encourage rather than discourage our efforts.

The **Chairman**. Thank you very much. We will stand in recess.

[Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 10:15 a.m., Wednesday, May 11, 1988, in room SR-332, Russell Senate Office Building.]

[Material submitted for inclusion in the record follows:]

COMMITTEE TO ASSURE THE AVAILABILITY OF CASEIN
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TESTIMONY OF

THE COMMITTEE TO ASSURE THE AVAILABILITY OF CASEIN ("CAAC")

BEFORE THE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

UNITED STATES SENATE

CONCERNING

REPORT AND RECOMMENDATIONS OF THE NATIONAL COMMISSION ON DAIRY POLICY

May 3, 1988

Max N. Berry, Esq.
Executive Director
and General Counsel

The Honorable Patrick J. Leahy
Chairman, Committee on Agriculture
Nutrition and Forestry
328A Russell Senate Office Building
Washington, D.C. 20510

RE: Report and Recommendation of the
National Commission on Dairy Policy --
Casein Imports Should Not Be
Restricted By Quota

Dear Mr. Chairman:

I. Introduction

This statement is submitted on behalf of the Committee to Assure the Availability of Casein ("CAAC") and discusses why there should not be a restriction on the importation of casein by quota action or by any other non-tariff barrier measure.

In particular, this testimony objects to a recommendation by the National Commission on Dairy Policy that casein imports be subjected to a Section 22 quota under the provisions of the Agricultural Adjustment Act, as amended. This proposal would reduce imports of casein when not one pound is produced in the United States! In addition, not one pound of casein is restricted by quota by any other country in the world!

Specifically, the Commission stated ". . . Because the current volume of casein imports interferes with the milk price support program, the volume of casein imports should be reduced and casein should be reclassified as a a dairy product and subject to Section 22 import quotas. . ." This testimony will document, based on existing facts, that casein imports do not interfere with the milk price support program and should not be subjected to Section 22 import quotas. The Commission, on the basis of a misinterpretation, misuse and misunderstanding of the facts, incorrectly, and in a protectionist manner, recommended a quota on imported casein. This testimony will establish that it would be against the interests of the United States and its consumers to institute such a quota. Before substantiating these conclusions, it would be appropriate to mention what the "CAAC" is.

II. The "CAAC"

The "CAAC", (membership list attached for information) was established in 1978 by U.S. companies when unjustifiable and unsuccessful attempts were lodged by certain sectors of the U.S. dairy producers industry to place a "Section 22" (Agricultural Adjustment Act of 1949) quota on imported casein. Thereafter, almost every year requests have been submitted to the Secretary of Agriculture or to the Congress seeking a quota against imported casein alleging that it disturbs, in a material way, the price support program. These unfounded, protectionist efforts are taking place once again.

The "CAAC" continues to resist these efforts which would ultimately harm, in many ways, the U.S. consumer and, at the same time, violate our country's international obligations under the General Agreement on Tariffs and Trade ("GATT").

III. The Commission's Casein Quota Recommendation Should Be Rejected

The following facts explain why the Commission's recommendation to restrict casein is unjustified and should be rejected:

1. Casein is not manufactured in the United States. Prior to the Agricultural Adjustment Act of 1949, which created price supports for nonfat dry milk, butter and cheese, casein was produced throughout the United States. When the Congress, at the request of certain segments of the dairy producers industry, decided to support nonfat dry milk and not casein, casein production went out of business "over night". As a consequence, today all casein is imported into the United States!

2. If casein were produced in the United States, unless it was significantly subsidized, it would have to sell between $3.00 and $3.50 per pound. Currently imported casein, most of which is from New Zealand, Ireland and Australia, sells for approximately $2.00 per pound. New Zealand, which establishes the world market price for casein, does not subsidize its exports to the U.S. It takes three pounds of liquid skim milk plus the cost of new manufacturing plants, machinery, land, utilities, labor and distribution system costs to sell casein. To take three pounds of liquid skim on today's market and to add the other mentioned cost factors means

casein would have to sell for over $3.00 per pound in our country -- over $1.00 per pound more than current import prices!

3. Nonfat dry milk produced in the United States cannot, in more than 90 percent of the uses for imported casein, be substituted for casein. No matter what one might hear from certain segments of the dairy producers lobby, food scientists and other technical authorities will attest to the fact that almost all of the uses for imported casein today cannot be met by the substitution of nonfat dry milk!

4. Since 1979, there have been four U.S. Government studies on casein! The International Trade Commission ("ITC") has held a Section 22 hearing and concluded that casein did not materially interfere with the price support program. The ITC held that quota restrictions or increased duties on casein would have no significant impact except to raise the cost to consumers by hundreds of millions of dollars! The ITC also had a fact-finding study in 1979 and concluded the same. Quotations from both of these investigations are given later in this testimony. The United States Department of Agriculture has had two investigations of casein within the last five years and both agree with the ITC findings. Again, quotations from the USDA are also given in this testimony.

5. A quota on casein or other restrictions on casein would be inflationary. The "CAAC" estimates that these costs could well add over $300 million a year to consumer costs.

6. Casein is a GATT item. To place an unfair nontariff barrier restriction on its importation would clearly violate the GATT and could cause retaliation by our trading partners. This statement should and can be verified with appropriate officials within the U.S. Government handling trade matters.

7. A quota or other restriction on imported casein would inhibit the production of hundreds of products utilizing casein -- from cool whip to coffee whiteners, to substitute low-cholesterol cheeses, other diet foods, pet foods, medical nutritionals which keep babies alive, high protein hospital formulas, industrial glues, and a host of other products! None of these products can use nonfat dry milk as a substitute for casein. Many would not be produced if casein were placed under a quota.

8. A quota would deny consumers their free choice of desired products. "Consumer choice" is the main issue in this casein dispute!

9. Section 105 of the Farm Security Act called for the reestablishment of a U.S. casein industry between June 1, 1986 and January 1, 1990. To date, there have been no offers of U.S. casein to any of our members who represent over 90% of the casein trade. Our country needs imported casein and it does not make sense to place it under quota when Section 105 is apparently not a success!

IV. History

As stated, in 1981, Secretary of Agriculture Block granted a Section 22 hearing which was conducted by the International Trade Commission. That Commission correctly concluded that imported casein was not materially disturbing the price support program! The facts have not changed -- currently casein imports do not materially disturb the price support program and no quota is justified.

The Section 22, ITC report of January, 1982 concluded on page 1:

> "On the basis of the information developed in the course of the investigation, the Commission finds and recommends that casein, mixtures in chief value of casein, and lactalbumin, provided for in items 493.12, 493.17, and 190.15, respectively, of the Tariff Schedules of the United States (TSUS), are not being, and are not practically certain to be, imported into the United States under such conditions and in such quantities as to render or tend to render ineffective, or materially interfere with, the price-support program for milk undertaken by the Department of Agriculture, or to reduce substantially the amount of any product processed in the United States from domestic milk." (Emphasis added.)

In addition, in 1979 the International Trade Commission conducted a fact-finding report under Section 332 of the Trade Act, and concluded that imported casein did not materially interfere with the price support program.

The ITC report of December, 1979 stated on pages 4 and 5 thereof:

> "The data collected during the course of the Commission's investigation indicate *virtually no relationship between imports of casein and mixtures of casein and purchases of nonfat dry milk under the price-support program in recent years. Likewise, no clear relationship is apparent between imports and domestic production or consumption of nonfat dry milk. Additionally, no clear relationship is apparent between imports of casein and mixtures of casein and other forms of domestic dairy production. Products of the dairy industry are not considered by most of the end users of the imports to be a primary or technically viable substitute for casein in many of its current uses.*

In addition, yet another study was conducted by the Department of Agriculture. This study, which was released in 1981 at the request of the Congress, also stated that if a quota was placed on imported casein, in conformity with Section 22 of the Agricultural Adjustment Act, that only *insignificant* results would be experienced with the price support program and therefore such a quota was *not* justifiable.

The Abstract of the 1981 study stated:

> "This study examines the economic implications of restricting the importation of casein and lactalbumin--dairy proteins used in various food, feed, and industrial products. Under existing legislation and trade agreements, the most extreme restrictions that may be imposed are a 50-percent quota or a 50-percent ad valorem tariff. If either of these were imposed, users of casein would shift to soy-based protein and other ingredients wherever possible, although product quality could suffer. Some casein use would be replaced by skim milk solids, *but not enough to significantly affect CCC purchases under the dairy price support program. Import restrictions would increase the cost of producing goods containing casein, and thus raise prices to consumers*." (Emphasis added.)

It is important for the Committee to note the facts found in these four government investigations have not changed in 1988. Casein imports still do not interfere with the price support program for the very reasons these different reports established. During the time period of these reports, "The Washington Post" published a very interesting article written by Robert G. Kaiser on November 8, 1981 entitled "How A Lobby Milks A Nonissue". This article is timely today and should be read by all who are interested in knowing more about the subject of imported casein. The article, in a detailed manner, states that dairy industry proponents of a casein quota are using casein as a "scapegoat issue" to disguise its other problems of overproduction and large government subsidies. These "dairy protectionists" do not acknowledge that these four past government studies on casein all concluded that no quota was justified. To reinforce the point that the facts have not changed since these four government investigations, "The Wall Street Journal" on June 4 of last year published an editorial entitled "Creaming Casein" subscribing to the findings of these past government studies that no casein quota is justified. The "Journal" concluded its editorial by stating ". . .It would be grimly ironic to see casein rise from the ashes of Smoot-Hawley to haunt the victims of another trade war." Both articles are included for the Committee's study and information.

V. The Whey Disposal Problem

Whey surplus is a major problem for many U.S. dairy producers and was a subject of a hearing by the Agriculture Committee of the House of Representatives not too many years ago. Billions of pounds of whey, a by-product of cheese production, are generated each year in the United States. With American cheese consumption on the rise, cheese production has increased significantly in recent years. This has brought about a related increase in whey availability, although the demand for whey products has not increased at the same rate.

Whey utilization is a serious problem facing U.S. dairy producers. While limited quantities can be used in specialty products, and the "CAAC" is encouraged by the progress being made in this area today, the vast bulk of this whey must be treated in company or municipal waste disposal facilities. In many locations around the country, existing pollution control facilities are straining to meet this increased demand placed on them.

If U.S. dairy producers were to produce 100 million pounds of casein, there would be billions of pounds of additional acid whey as a by-product which would seriously jeopardize existing disposal facilities!

VI. No material Price Support Impairment

Current casein imports do not materially interfere with the dairy price support program for the same reasons given in the previously cited government studies. The following table and chart prove that casein imports do not relate to CCC purchases of nonfat dry milk, from 1970 thru 1987!

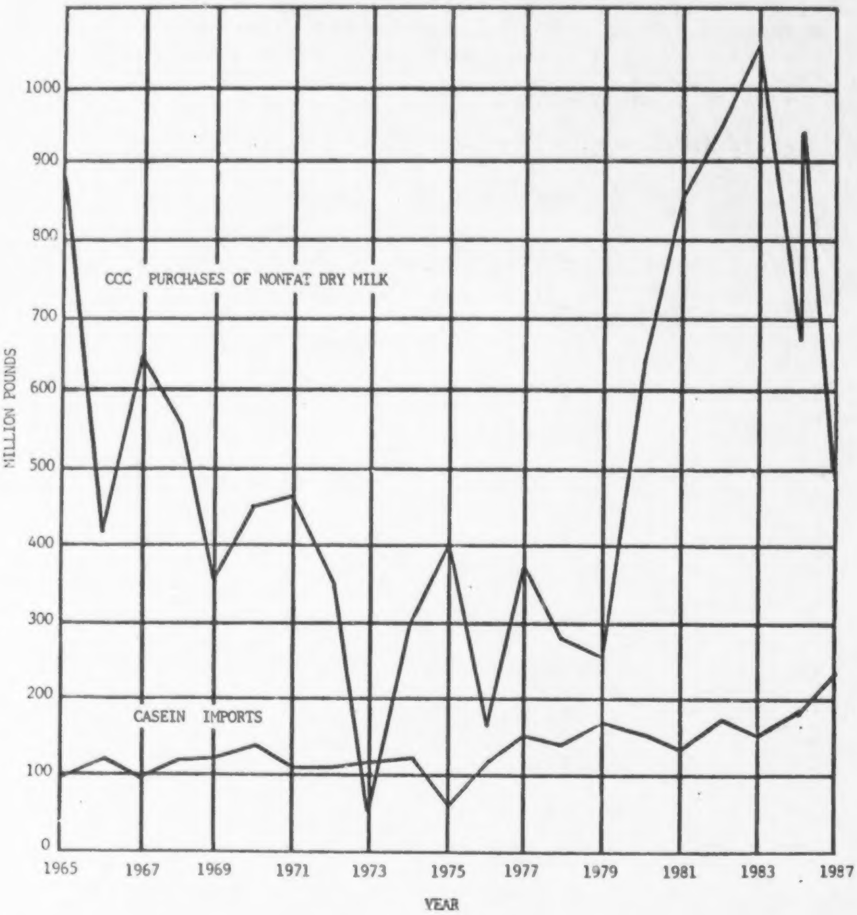
CASEIN IMPORTS DO NOT RELATE TO CCC PURCHASES OF NFDM

Millions of Pounds

Year	Casein Imports (1)	CCC Purchases (1) of NFDM
1970	135.3	451.6
1971	105.9	456.1
1972	105.4	345.0
1973	112.8	36.8
1974	113.3	265.0
1975	58.4	394.5
1976	112.1	157.1
1977	146.5	461.7
1978	137.1	285.0
1979	151.0	255.3
1980	151.2	634.3
1981	127.8	851.3
1982	176.8	948.1
1983	159.5	1061.0
1984	192.3	678.4
1985	234.0	940.6
1986	229.7	827.3
1987	237.8	496.4

(1) USDA Statistics

USDA PURCHASES OF NDM AND CASEIN IMPORTS



* In 1977, dates of Marketing Year were changed; However, during this 6 month transition period, 345.5 million lbs. were purchased.

Conclusion

Because casein clearly does not materially interfere with the price support program, because it is not produced in the United States and would be highly inflationary and require large government subsidies if it were, and because U.S. consumers want and need casein-based products, a quota, of any type, or other nontariff barrier restrictions should not be imposed. Some of the largest U.S. dairy cooperatives in business today are significant purchasers and users of imported casein, and dairy families are consumers of casein products just like everyone else!

The "CAAC" sincerely appreciates the consideration by the Committee of its views. We conclude by stating that available facts are convincing that the Commission's report is simply wrong in its recommendation that a quota be imposed on imported casein. The rejection of this recommendation is urged by the "CAAC".

Respectfully submitted,

Max N. Berry
Executive Director
and General Counsel

Attachments follow:

"CAAC" Membership List - May, 1988

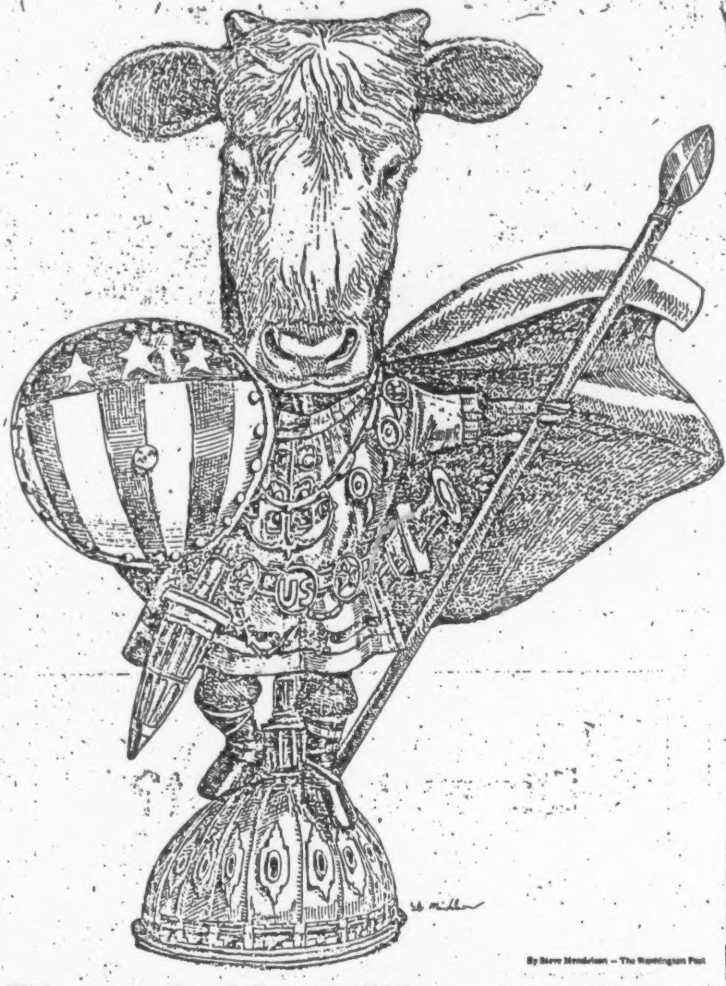
Abbott Laboratories
American Feeds & Livestock Co., Inc.
Anderson Clayton Foods
Beatrice Foods
Besnier Scerma, USA
Borden, Inc.
Bristol Meyers
    Mead Johnson & Company
Carnation Company
Dairyland Products, Inc.
Dean Foods Company
Deltown Chemurgic Corporation
Dorman Cheese Company
Erie Casein Company, Inc.
Excelpro, Inc.
Farbest-Tallman Foods Corporation
Freeborn Foods Company
Galaxy Cheese Company
General Foods Corporation
W. R. Grace
    DeZaan, Inc.
Irish Dairy Board
Kerry Foods, Inc.
Kraft, Inc.
    Humko Sheffield Chemicals
    Sheffield Products
Liberty Enterprises
Merrick Foods, Inc.
National Casein Sales/N.J.
New Zealand Milk Products
Norseland Foods, Inc.
Pet, Inc.
The Pillsbury Company
Quaker Oats Company
Sandoz Nutrition Corporation
Schreiber Foods, Inc.
Trugman-Nash, Inc.
Unilever United States, Inc.
    Stauffer Chemical Co.
    Milk Proteins, Inc.
Universal Foods Corporation
Vitamins, Inc.

ALLIED GROUPS

Virginia Port Authority
Delaware River Port Authority
Frozen Potato Products Institute
Entreal Nutrition Council
National Customs Brokers &
  Forwarders Association

NOVEMBER 8, 1981

The Washington Post OUTLOOK



By Steve Mendelson — The Washington Post

How a Lobby Milks a Nonissue

By Robert G. Kaiser

IN THE GALLERY of dubious issues invented in Washington, let history make room for casein, a substance that seems ideally suited for the conversion of molehills into mountains.

Casein is milk protein, and it is a marvelous product — the dairy cow's answer to Kryptonite. It is used to make pharmaceuticals, glue, paper coatings, coffee whitener, artificial whipped-cream topping, baby formula, imitation cheese and probably the occasional kitchen sink.

Casein also makes a big political furor, thanks primarily to the dairy lobby, which seems determined to gain a symbolic victory on casein simply to demonstrate it can win on some issue. Any issue.

Hundreds of thousands of taxpayers' dollars have already been spent investigating casein. Now President Reagan's secretary of agriculture wants to cut the import of casein by half, a move his own department says would cost U.S. consumers $115 million.

Reagan has gone along by asking for yet another government study of casein, which will cost tens of thousands of dollars more. So tomorrow morning the International Trade Commission, the government agency empowered to investigate charges of unfair trading practices, begins this latest inquiry.

Robert G. Kaiser is a Washington Post staff writer who has been reporting periodically on dairy industry lobbying.

See CASEIN, Page C3

CASEIN, From Page C1

The story of casein is an example of the way lobbyists and members of Congress can seek out issues that might make them look good with voters at home and with the clients who hire them to influence government decisions. Import restrictions on casein would not measurably improve any dairy farmer's standard of living, but the lobbyists and some members of Congress have been working for such restrictions as though they were crucial to the farmers' survival.

□ □

Among casein's many unusual qualities is this: None of the stuff is "Made in U.S.A." This country is by far the world's leading producer of milk, but the government's dairy price support program does not cover casein. Therefore, producers would lose money if they manufactured casein, a product that comes from the same milk curds that go into cottage cheese. So all the casein used here must be imported.

That's the rub. America is a free-trading nation in principle, but not in agricultural products. Few agricultural commodities and no dairy products can come into this country freely, but casein is officially categorized as an industrial, not an agricultural, product. There is no limit and no duty on its importation, and it comes in at a cheap price compared to other forms of milk protein.

On the basis of these facts, the American dairy industry, and particularly its representatives in Washington, have decided to make a big — yea, an enormous — deal out of casein.

The principal figure in this effort is Patrick B. Healy, secretary of the National Milk Producers Federation. Healy contends that imports of casein "must be controlled" to preserve markets for U.S. dairy products and to reduce the cost of the government's dairy price support program. Healy has been fighting for restrictions on casein imports since Earl Butz was secretary of agriculture.

The dairy industry's friends in Congress have been echoing Healy's certainty about the ill effects of casein imports as if they had read the message on a new stone tablet. "Look at casein," shouted Rep. James M. Jeffords (R-Vt.) in a recent House debate. "If we just eliminate casein imports, we do away with 3.3 billion pounds" of milk surpluses.

The dairy industry argues that if casein imports were limited, users would turn to nonfat dry milk as a substitute, increasing consumption of that product. That would reduce government surpluses of nonfat dry milk, the industry says, thus lowering the cost of the dairy price support program.

If the program can be made cheaper, the industry argues, there would be less justification for holding down the basic dairy price support.

□ □

This is the industry's line. It has all the intellectual sinew of a cover story. In fact, dry milk cannot be used for most of casein's uses. There wouldn't be much substitution, according to all the government studies, and according to industry officials, too. The suspicion is irresistible that the dairy lobby in Washington is primarily interested in casein as a fight it might win.

"It's a classic example" of the way lobbyists look for issues to score points on, according to Ellen Haas of the Community Nutrition Institute, a "public interest" lobbying organization. "They had to win on something."

It is indisputable that the dairy lobby has not been having one of its best seasons. Tough and resourceful as ever, it has been unable to avoid the repercussions of huge government-owned surpluses of dry milk, cheese and butter — surpluses produced in part by the lobby's past successes in raising basic dairy price supports.

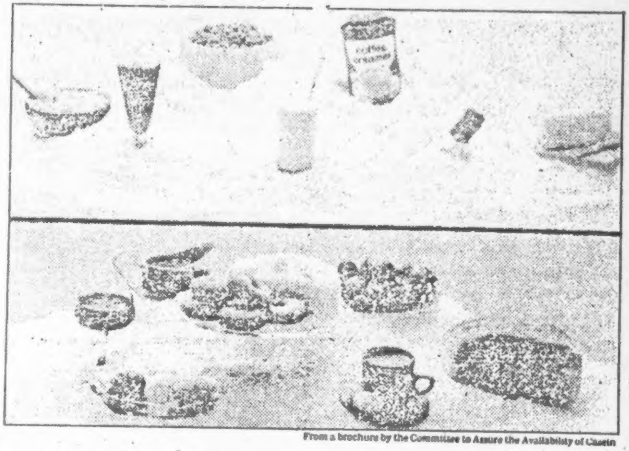
This year dairy farmers are hurting. Their prices are not keeping up with inflation, and their real incomes will fall. Healy and others in Washington who have to explain these unhappy developments to their troops presumably would like to have a victory on casein to balance the bad news.

As an official of one of the big dairy coops put it, action restricting casein imports would have "a tremendous psychological impact. It's all we've got. You've got to get something out of Congress."

One of the dairy lobby's traditional advantages has been tenacity, and the casein crusade is no exception. Healy has been pressing it for years, and in 1979 he persuaded the House Ways and Means Committee to ask the International Trade Commission to investigate the impact of casein imports.

Unfortunately for the dairy lobby, the ensuing study did nothing to bolster its case. The ITC concluded that there was "virtually no relationship between imports of casein and the purchases of nonfat dry milk under the price support program." The commission found that powdered milk could not be substituted for most uses of casein, which depend on its unique physical properties.

The dairy lobby rejected that finding and began to press the Carter administration to conduct another study, this one inside the Agriculture Department. Bob Bergland, Jimmy Carter's secretary of agriculture, held the dairy lobby off for months. But in the spring of 1980, shortly before the important Wisconsin ("America's Dairyland") primary, he put the new study into motion. "We can't prove there was a connection between the two events," a smiling civil servant at the department said later.



From a brochure by the Committee to Assure the Availability of Casein

Last June the department's study was published. It concluded that the Trade Commission had been correct — neither import quotas nor a duty on casein would significantly affect consumption of powdered milk.

Under the law, it would be possible either to reduce imports by up to half the amount imported in a representative recent period of time, or impose a duty of up to 50 percent of the value of the casein. The Agriculture Department's study concluded that a quota roughly cutting imports in half would convince most users of casein to do without the stuff or find substitutes based on soybeans, not powdered milk. The report estimated that just 10.3 million additional pounds of powdered milk would be consumed each year. (The government currently has 800 million pounds of powdered milk in storage, and is adding millions more each week.)

A 50 percent import duty would result in "no increase in the use of domestically produced skim milk solids," the report said. Either move, it said, would add tens of millions of dollars to the retail costs of products based on casein.

Despite the real conclusion that no legal quota or duty would significantly affect the consumption of powdered milk, the lobby preferred this sentence in the report:

"If no casein had been imported in 1980, commercial disappearance (that is, use) of domestic skim milk solids would have increased by the equivalent of 333 million pounds of nonfat dry milk. Thus government

How a Lobby Milks a Nonissue to Stay Alive

purchases of nonfat dry milk would have been 333 million pounds lower, saving about $300 million on Commodity Credit Corp. outlays (for the purchase of surplus milk)."

Kenneth Clayton, author of the report, admitted in an interview that this hypothetical proposition has no basis in reality, not least because there would be no legal way to block all imports of casein, and even the dairy lobby says it doesn't want to do that. (Much casein is used for pharmaceutical products and baby formula for children who can't digest milk.)

Moreover, there would never be full substitution of milk for casein. Clayton said of this figure, "Not that it was very realistic . . . but we needed a base."

□ □

Realistic or not, friends of the dairy industry like the number. Rep. Thomas E. Petri (R-Wis.) used it in a recent House debate. Noting that the U.S. imported 152 million pounds of casein last year, "the equivalent of 333 million pounds of nonfat dry milk," Petri told the House: "All or most of this amount of milk may have been sold on the commercial market if it were not for the imported casein."

Later Petri was asked for the basis of this contention. "It just says 'could have,' " Petri said of his statement on the floor. He said he knew the Agriculture Department had concluded that milk could not be substituted for casein, "and that could well be true." He was speaking of a hypothetical case in which the government banned all casein imports, he said.

Sen. David Boren (D-Okla.) made Petri's use of figures look conservative in a Senate debate. Last year's casein imports displaced "upward of 4 billion pounds of domestically produced skim milk," Boren declared solemnly, offering no rationale whatsoever for his assertion.

In private conversation, some dairy lobbyists argue that the real problem with casein is prospective — that its use is growing fast and could take off if not controlled. But the facts don't sustain this contention either.

This year, it appears, casein imports will total about 135 million pounds, some 17 million pounds less than last year and roughly the same level as in 1970. Casein imports jump up and down from year to year.

It is true that an increasing amount of casein goes into food products, particularly imitation cheese. Most of that apparently ends up in pizza.

Imitation cheese made with casein is cheaper — and much less tasty — than the real thing. There is a growing market for the stuff, part of it for straight imitation cheese eaten by people on diets restricting their intake of animal fats.

However, it isn't easy to make a case that casein imports — or anything else — is holding down consumption of real cheese. Americans are on a cheese binge. From 1970 to 1980, consumption of real cheese in this country grew from 2.3 billion to 4 billion pounds. This is the only segment of the dairy industry that is booming.

□ □

The dairy lobby and its friends in Congress seem to realize that they cannot make too strong a case for a significant cut in casein imports, so they have recently taken a different tack.

Originally the industry and its supporters sought a "zero quota" in casein imports, as Healy noted in a recent interview. (Now he says charges that the industry wants to exclude all casein imports are "ridiculous, ridiculous.") Then the lobby went for a quota that would cut imports by more than half.

But in September, Sen. John Melcher (D-Mont.), one of the dairy lobby's staunchest allies, introduced a new resolution in the Senate calling for a quota of about 140 million pounds a year, the average level of imports over the past five years. The Senate actually endorsed this proposal in a nonbinding attachment to its version of the farm bill.

Asked why the industry had modified its objective, Healy said it was a matter of "what can be obtained." Neither house of Congress appeared willing to go along with deeper cuts, Healy said. "It's extremely important that we do cap these imports at some point," Healy added. "More and more erzatz foods are being developed from it," he said, noting that this seemed to be a pattern in other foodstuffs, too. "These foods that we have eaten for millenia, that have nurtured us to where we are, should not be tampered with," Healy added.

This latest gambit leaves the industry in a quandary. It sought an International Trade Commission investigation on the ground that the current level of imports "materially interferes" with the dairy price support program. Now the industry seeks an import quota that would preserve the current level of imports.

This is one of the issues the ITC will have to deal with at the hearing that begins tomorrow morning.

An Editorial

THE WALL STREET JOURNAL, June 4, 1987

Creaming Casein

Under what circumstances would American consumers agree to a 50% quota on an imported product that ultimately raised its domestic price by 100%? What if there were no substitute for the product, and it was not produced in the U.S.? What if it were an essential ingredient in hundreds of other products? Under such circumstances, it is likely Americans would revolt. That is, of course, unless we happened to be at war with the exporting nation.

But we are not at war with New Zealand, Ireland or Australia, the leading exporters of the milk byproduct casein. All these countries will be subject to a 50% quota (or some similarly Draconian trade restriction) if the dairy lobby has its way. But a trade skirmish with these three nations is a real possibility if the House and Senate refuse to drop the casein restrictions, which are yet another of the legislative gargoyles being discovered in the pending trade bill.

Casein may not be a household word, but Smoot-Hawley certainly is. The infamous 1930 monument to mindless tariff protectionism pitched the world into a trade war and contributed to the ensuing Depression. Embedded in that bill, believe it or not, was casein, whose tariff rate was jacked up by the Senate on Oct. 24, 1929. After all these years, the ghost of casein is being resurrected by the protectionist Congress of 1987.

Casein is used mainly as an ingredient in food products such as whipped cream, coffee whiteners, diet foods and baby nutriments. It is also used to make glues and other industrial products. The dairy lobby asserts that nonfat dry milk—produced domestically—can be substituted for casein, but casein users maintain there is no substitute for it in more than 90% of its uses.

If casein were produced domestically—as it was prior to the Agricultural Adjustment Act of 1949 (which created price supports for nonfat dry milk, butter and cheese, but not casein)—it would likely sell for $3 to $3.50 a pound. This is more than double the world market price of $1.15. The eventual cost to American consumers would be something on the order of $300 million a year. That is unless Congress decided to subsidize casein producers, in which case taxpayers would bear the cost of this protectionism.

U.S. dairy producers allege that casein interferes with the federal price-support program. But four government reports in the past seven years cast serious doubts on such claims, including a 1982 International Trade Commission report that concluded that casein imports did not "materially interfere with . . . the price-support program for milk."

There is little logic in adding the costs of a casein tariff to the billions of dollars already spent yearly in subsidizing agriculture. By disturbing the casein market, Congress would only make it more difficult to obtain a product not made in this country, a product essential to the production of hundreds of other products.

The casein story should alert consumers and all who have an interest in an orderly world trading system to the importance of monitoring a piece of legislation as volatile as the trade bill. It would be grimly ironic to see casein rise from the ashes of Smoot-Hawley to haunt the victims of another trade war.

STATEMENT OF THE NATIONAL FARMERS UNION ON THE NATIONAL COMMISSION ON DAIRY POLICY REPORT

SUMMARY

National Farmers Union believes:

1. National dairy problems require national solutions.
2. Federal milk marketing orders should be maintained, but consolidated where economic efficiency and producer returns can be maximized.
3. Fair rules of international trade are essential to the success of domestic farm programs. For example, casein should be reclassified as a food product.
4. Domestic feeding programs should be a national priority, but should not be attributed to the cost of the dairy program.
5. Proper labeling of food products is important to farmers and consumers alike. People should know when they're buying both imported and imitation foods.
6. New technologies should be evaluated for health, safety, and efficacy prior to being marketed.
7. While farm ownership types are varied and changing, Congress should continue its efforts to target program benefits to those who need them. The continued economic viability of family-scale dairy farms is a legitimate goal of federal policy.
8. It is imperative to retain and move towards the parity objectives of the dairy support statutes and the federal milk marketing order system.
9. It is pointless to propose more discretionary authority for a Secretary of Agriculture who will not use existing powers regardless of compelling needs.
10. Supply management, rather than successive price support cuts, ought to be the first alternative in dairy policy.

The National Farmers Union is a general farm organization representing 250,000 family farmers and ranchers throughout the United States. Our members produce many different commodities, including dairy. Our organization has an affliated cooperative, the Farmers Union Milk Marketing Cooperative, which is the third largest dairy cooperative in the country. We have an active Dairy Council, with representatives from ten different dairy states, from Washington to New York. The membership of that group is attached to this statement as Appendix A. While this group provides on-going feedback to our Washington, D.C. staff, the positions of the National Farmers Union are adopted by member delegates at our annual meeting. Our 1988 dairy policy statement, adopted by the delegate body in March, is attached to this statement as Appendix B.

In debating our policy, our delegates went through many of the same discussions, from the same variety of perspectives, as did the National Commission on Dairy Policy (Commission). In reviewing the Commission's report, Farmers Union has found many areas in which we agree with its findings. However, there are also several fundamental areas in which we cannot accept the position taken by the Commission.

We agree with the Commission that questions of supply and demand, as they relate to dairy policy, are national problems requiring national solutions. A national price support program that tries to pit one region of the country against another will not work. The same is true of the federal marketing order system. The Commission correctly points out that, in many respects, the existing formula for transportation differentials operates to the benefit of some regions and the detriment of others. We agree that Congress should not play a role in establishing differentials. We agree that allowing an individual state to continue its own marketing order based on a different price from the Minnesota-Wisconsin price and using a different manufacturing allowance is counter-productive to a national program.

The milk marketing order system should be maintained, although there is room to improve the system to bring it up to date with modern marketing conditions. We support consolidation of orders to maximize economic efficiency, providing that consideration is also given to maximizing producer returns. We also support the Commission's request that USDA be more responsive in its marketing order hearing process.

The Commission accurately states the need to have fair trade rules in place for a domestic program to operate properly. We can't expect domestic producers to continue taking price cuts to keep government costs down, while at the same time allowing unfair levels of imported dairy products to displace markets. Casein should be reclassified as a food product to bring it within Section 22. Continued use of Section 22 quotas is critical to the success of any program designed to lower CCC purchases.

We agree with the Commission that CCC bookkeeping practices need to be revised to reflect actual surpluses. The dairy program's budget should not be charged with the cost of supplying the Department of Defense. We believe that domestic feeding programs, such as school lunches and TEFAP, are very important and should be fully funded. But, like the Commission, we do not believe that these programs' costs should be attributed to dairy farmers.

We agree with the Commission that there should be accurate labeling of foods so consumers know whether they're buying real or imitation products. We support the use of the "real seal" and other dairy promotion efforts. We agree that the functions of UDIA and the National Dairy Promotion Board should be merged.

Finally, we agree that new technologies, such as bovine somatotropin, should not be marketed until all potential health and safety concerns -- both for dairy cows and for humans consuming dairy products -- have been evaluated. We would go further than the Commission to recommend that the efficacy of new technologies also be evaluated prior to marketing the product. A new product isn't necessarily a better one. It is important to know if a new product will meet an existing need and/or if it might be creating more problems than it solves.

National Farmers Union is deeply disappointed that the Commission chose to avoid the issue of what constitutes a family farm and recommended against targeting farm program benefits. We fundamentally disagree with the Commission's apparent belief that the only proper goal for dairy policy is the orderly flow of milk around the country. This market orientation was the driving force behind the Agricultural Marketing Agreement Act of 1937, which made several adjustments to the marketing order system to insure sufficient quantities of fresh milk to consumers. But the purpose of the Agricultural Adjustment Act of 1933, which began the practice of government purchases of dairy products, was unquestionably to improve farm income. It is ridiculous to suggest that there is no role in federal farm policy for making sure we still have farmers in the United States. That goal is the cornerstone of farm programs, and it is no less significant to the American economy and society today than it was in 1933. Perhaps the Commission is free to ignore the social implications of its recommendations, but the Congress is not.

The Commission believes that a program based on its recommendations will lead to profitability in the dairy industry. Our question is, for whom? Who will be left if we continue a policy of cutting prices as the first alternative? With the variety of ownership types available, it is difficult to find the ideal definition of a family farm (see Appendix C). But that is not an excuse for giving up on trying to target program benefits. In other commodities, definitional problems have led to greater

Congressional efforts to target programs. Attempts to refine the definition of a "person" for purposes of the $50,000 payment limitation make a timely example.

We also object to the Commission's recommendation that the parity formula be replaced. While the Commission could not have been expected to flesh out a detailed alternative, we see little in its general index guidelines to suggest that it would work better than the parity index. Further, we believe that it is very important to maintain the goal of 75 to 90 percent of parity as spelled out in the permanent price support program of the 1949 Act. To eliminate the possibility of a return to parity is to acquiesce in a cheap food policy that will always leave agriculture lagging behind the rest of the economy.

We cannot accept the Commission's view that continued price cuts should be the first alternative in controlling supply. The immediate effect of such a price decrease is a production increase, as farmers scramble to make up lost revenue. The Commission realized this when it added stand-by supply management measures to its recommendations. The long-term effect of continued price cuts is to put farmers out of business. Why not use supply management as the first alternative, to bring supply and demand in line without wreaking havoc in rural communities?

The Commission would give the Secretary discretionary authority to lower the support price up to fifty cents per hundredweight. If that doesn't bring CCC purchases between five and seven and one-half billion pounds milk equivalent, he could implement one of two approved supply management plans. This is not a significant departure from current law. The Secretary has the authority right now to implement either a diversion or termination program. The National Farmers Union, the Farmers Union Milk Marketing Cooperative, and the National Farmers Organization have been working for months here in Washington, D.C. and across the country to convince the Secretary to use that authority. The price cut of January 1, 1988 was unnecessary, as is the scheduled cut for January 1, 1989. At the press conference held to unveil the Commission's report, Secretary Lyng was asked if he would use his authority to implement a diversion program to avoid the next price cut. He flatly refused. The Commission's recommendations are meant to be long-term, but we do not see progress over current law in giving the Secretary more discretionary authority.

We feel the Commission also recognized this shortcoming when it decided that at some point supply management should be mandatory. This is a fairly substantial departure from current law, and one which we would gladly support were it not for the fact that it only happens after a fifty cent per hundredweight support price cut.

Finally, we were amazed to see the Commission report snipe at the Agricultural Credit Act of 1987 by denouncing credit policies that "disadvantage farmers who operate on a businesslike basis" (page 20). The commission alleges a $7 billion bailout of presumably inefficient farmers by the Farmers Home Administration. It is unfortunate that the Commission did not put the research effort into this issue that it obviously did into others. Had they done so, they would have realized that the credit legislation simply recognized money that was already lost, largely through diminished land values rather than producer inefficiency. This law in itself will not cost the government $7 billion. Further, the law requires debt restructuring only when it is the least cost alternative, so regardless of the cost of restructuring, by definition foreclosing on those farmers would cost more. The Commission did itself a disservice by straying from dairy policy.

The report of the National Commission on Dairy Policy provides a useful starting point for the discussion leading up to the next farm bill. It raises many of the questions which Congress will have to address. National Farmers Union intends to continue an active role in developing long-term farm program recommendations that continue to meet farm policy needs.

Thank you.

Appendixes A, B, and C follow:

APPENDIX A

NATIONAL FARMERS UNION DAIRY COUNCIL

Wisconsin

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Minnesota

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Utah-Idaho

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Pennsylvania

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South Dakota

Dallas Tonsager, President
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Oklahoma

Mr. Gene Mungle
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Ex-Officio

Leland Swenson, President
National Farmers Union

Cheryl L. Cook, Esq.
Dairy Council Staff Moderator

APPENDIX B -- National Farmers Union, 1988 Policy Statement

Dairy Policy

Farmers Union supports the concept of a long-term supply management program for dairy. We support implementation of either a voluntary or mandatory supply management program to prevent CCC purchases from becoming excessive.

Regrettably, the Secretary of Agriculture missed a major opportunity under the 1985 Act to implement a dairy diversion program to offset effects of the 1988 price cut and to prevent future price support and Gramm-Rudman cuts. We urge other groups to join us in lobbying for dairy diversion.

We support a mandatory program that would go into effect with a simple majority vote of individual dairy producers.

If a mandatory program is in effect, we recommend that:

a. The base be set at the preceding year's production history.
b. Producers who participated in the Dairy Termination Program would have no base history.

The price support level must be established as a percentage of parity. The rate to dairy producers must not be less than 71 percent of parity.

If a mandatory program is not in effect, we recommend the reinstitution of a paid milk diversion program and/or a dairy buy-out program.

We recommend that the Dairy Task Force study the pros and cons of regionalizing milk production areas so that they may be able to handle their own problems.

We support the accelerated merger of United Dairy Industry Association (UDIA) and the National Dairy Promotion and Research Board.

We call on Congress to repeal the Class I differentials legislated by the Food Security Act of 1985 and return the authority to establish differentials to the Federal Milk Marketing Order Administrators, through the hearing process.

We urge acceleration of market order consolidation to achieve uniformity in pricing in regional areas and to maximize net return to producers.

The federal government and milk producing states should be encouraged to enact legislation adopting component pricing of milk, including the use of protein.

The Food and Drug Administration (FDA) should increase the federal minimum standards for fluid whole milk to 8.7 percent milk solids non-fat; 10 percent for low fat; and 9 percent for skim solids non-fat. In the best interest of both consumers and dairymen, FDA should do everything in its power to ensure that all milk marketed as fluid milk meet or exceed these standards.

We encourage state legislatures to adopt standards for milk which are at least equal to or greater than current federal minimum standards.

As casein imports cost American taxpayers in excess of $600 million annually, major reductions in the current import levels of foreign subsidized casein should be instituted. If casein is to be used for food, it should be classified as a food and inspected by the United States Department of Agriculture (USDA).

Since casein imports displace millions of pounds of U.S.-produced milk annually, we urge Congress to adjust the 7.5 billion pound trigger level proportionately in the dairy program in order to protect the support price to United States farmers.

We applaud Congress' action to reclassify casein as a food product and request that it take similar action this year.

We request that dairy products imported into the United States shall be required to be produced and manufactured under the same quality standards as are required by domestic products, and that the cost of such inspection be borne by the exporter or exporting country of origin.

Public programs and private efforts to reduce government-held dairy stocks should be expanded. This should include full funding of the school milk program and special milk program to 1980 levels.

We are opposed to regulations which allow the use of dairy terms, i.e., milk, cheese, cream, cheddar, etc., in labeling imitation and substitute dairy products. The use of dairy terms on these labels is deceptive to consumers and allows manufacturers of these products to benefit from the wholesome reputation of natural dairy products. Consumers should be informed of the use of imitation cheese in pizza and other prepared products.

A dairy indemnity program, similar to that in the 1977 Farm Act, should be reinstituted.

Recognizing that brucellosis continues to be a problem for livestock producers, Congress should provide adequate funding for the eradication of this disease.

The commercial use of Bovine Growth Hormone should be prohibited until social and economic impact studies are completed and the FDA has conducted a long-term study to prove that the product is totally safe and does not jeopardize the future health of the American people. Further, this product should not be marketed until the dairy industry has a long-term supply management program in effect.

We support continuance of the National Farmers Union Dairy Task Force.

APPENDIX C -- National Farmers Union 1988 Policy Statement

PREAMBLE

The family farm is the keystone of our policy. Family agriculture is the base of viable rural communities and a strong society.

We remain wholly dedicated to the strengthening of the family farm system and farmer cooperatives and resolutely opposed to an industrialized type of corporate farming or to domination of farm ownership and operation by off-farm or alien interests.

Our American system of farming is the most viable system of food and fiber production; it is in the best long-term interest of the nation; and it provides the most widespread benefits to all in our society. Yet, its survival and continuance are not automatic nor assured to our society.

Congress has often reaffirmed the "historic policy of the United States to foster and encourage the family farm system of agriculture in this country," but this federal commitment is meaningful ONLY if policies and programs are implemented and administered to effectively achieve the results intended by Congress.

The recommendations set forth in this policy statement are designed to reaffirm the family farm structure as the primary agricultural system, to assure rural and urban stability, national prosperity, the preservation of human and natural resources, and the dignity of the individual and family.

ARTICLE I
AGRICULTURAL PROGRAMS FOR THE FAMILY FARM

A. Family Farms

Characteristically, a family farm is owned and operated by a farm family, with the family providing most of the labor needed for the farming operation, assuming the economic risk, making most of the management decisions, and depending primarily on farming for a living.

Ideally, the family farm should be an economically adequate production unit which provides the farm family a net income comparable to the net income of families in other sectors of our society.

B. Family Farm Structure of Agriculture

The family farm continues to be the best choice for the American people in terms of assured abundance, efficient production, care of land and water resources, rural development, quality of life in rural communities, and contribution to export earnings and a more favorable balance of trade. Agriculture has unique characteristics and differs markedly from other enterprises.

Therefore, we reaffirm the National Farmers Union's position that federal policies and programs are essential to protect family farmers against the hazards of the marketplace, where almost every- one -- except the farmer -- is protected. Public policy must involve itself in helping to sustain the independent farmer in an economy which is otherwise strongly organized -- in which most other production is planned, most marketings are rationed, and most prices and profits are administered. We are cpposed to proposals to "decouple" government assistance to farmers by providing farmers with direct payments not tied to prices and production.

C. Economic Equity for Farmers

Workers have a minimum wage and the right to collective bargaining; many consumers have the advantage of having earnings or income linked to the Consumer Price Index; and regulated industries have a guaranteed return.

In agriculture, an economic yardstick is essential, both to measure the fairness of the prices and income received by farmers, and to serve as the basis for establishing farm stabilization goals and support program levels.

Continued research and study should be directed toward assuring a satisfactory benchmark for farm prices and income. Until such time as Congress legislates a superior new yardstick, parity remains the best and only legally recognized standard, and we recommend that price and income stabilization levels for each supported commodity should be expressed in terms of parity.

The Secretary of Agriculture should exercise, to the fullest extent, the powers conferred upon him by Congress to maintain parity prices to farmers for all agricultural commodities.

D. National Farm and Food Policy

On balance, the farm programs of the last half-century have been helpful to farmers and to our society.

Since 1970, however, family farmers have witnessed a deterioration in the price support and supply management provisions of each succeeding four-year farm law. The Food Security Act of 1985 is a continuation of that trend, and has become the most expensive, the most complicated, and the least effective farm law in modern agricultural history.

The original goal of national farm policy was to provide family farmers a parity of income with families in the other sectors of our national economy. That goal has been almost forgotten in the maze of current national farm policies, with the result that family farmers have become residual, rather than primary beneficiaries of federal farm policies.

SENATE AGRICULTURE COMMITTEE

REGARDING DAIRY POLICY

in behalf of

The Trade Association of Proprietary Plants

by

Robert J. Williams, Executive Director

My name is Robert J. Williams. I am Executive Director of the Trade Association of Proprietary Plants representing 27 privately owned dairy plants in Wisconsin and Illinois. Prior to my present position my experience in the dairy industry included: General Manager of Wisconsin Dairies Cooperative, Dairy Marketing Specialist for the State of Wisconsin, ASC office manager and vocational Ag. instructor. I was born and raised on a dairy farm so have had some 50 plus years of experience in the dairy industry in one capacity or another.

LEAHY'S REGIONAL DAIRY SUPPORT BILL

Generally speaking this is the worst piece of dairy legislation that has been formulated in many a year. In effect it would divide our national market for milk and dairy products into regional markets with separate supply-demand problems and solutions. It would lead to gross inequities, mis-allocation of resources and create disorderly and inefficient marketing and not be in the best interests of producers or consumers.

More specifically, the Leahy bill would create the following problems in the dairy industry:

1. It would allocate production by areas; as a result, efficient producers can be penalized and inefficient producers can be rewarded. Much would depend on the luck of the draw as to where regional lines (including assessments and supply control) are drawn. None would want to be included in a region with heavy sales to C.C.C.
2. It would allocate markets to producers. Deficit areas would increase production unfettered to needs of their region. Producers in surplus areas would be assessed price penalties to discourage production to the needs of their region. The Leahy bill would further segment the dairy industry by allowing production control programs on a regional basis.
3. The Leahy bill creates equity problems for producers as well as handlers, not only in terms of the right to compete on the basis of efficiency but by administrative and political instead of market driven economic forces. This can lead to misallocation of this country's natural resources.
4. The Leahy bill would lead to unfair trade and competition. To avoid sales to C.C.C. assessments or supply control programs, handlers and producer cooperatives would be encourages to increase commercial sales into other regions

at lower prices. This would undercut the objectives of the Price Support and Federal Milk Marketing Order programs. Also, surplus milk in one region would shift to other regions to avoid assessments etc.

In summary, the Leahy bill punishes efficiency, encourages inefficiency, raises prices to consumers, ignores inter-regional variations in production and consumption and creates equity problems. It rejects the economic theory of comparative advantage in favor of regional self-sufficiency. Existing production patterns would be frozen, including inefficiency. It locks out long term needed adjustments on a national basis. It ignores manufactured products movement in a national and international market.

The Leahy bill could result in inefficient production going to consumers and efficient production to C.C.C. The only redeeming factor in the Leahy bill is that it could cut Government costs but in the long run these would be offset by increased costs to consumers via inefficient and disorderly production and marketing.

THE DAIRY POLICY COMMISSION REPORT

The Dairy Policy Commission report contains pluses and minuses for the dairy industry.

The pluses include giving the Secretary discretiohary authority to impose controls on milk production when Government dairy product purchases exceed 5 billion pounds. Also, making it mandatory that the Government uses controls if Government dairy surpluses rise to 7.5 billion pounds.

The minuses include: the use of a market oriented formula to set the purchase price for dairy products not sold in the commercial market and the use of whole-herd buyout and/or a two tiered price plan to control production.

The discretionary authority at 5 billion pounds and mandatory authority at 7.5 billion for production controls is necessary to provide the proper signal to producers in regard to the needs of the commercial market. It also in large part removes the politics from the decision making.

Any production control programs should be accompanied by a step-wise reduction in price supports as were contained in the 1985 Farm Bill. Farmers must realise that there is no such thing as unrealistically high (above market clearing levels) prices and unlimited production. The price support program worked well until the late 1970's when Congress raised price supports to 80% of parity with semi-annual adjustments. Since then we have had major surplus problems.

The surplus problem was worsened by the cheap feed grain policy in the 1985 Farm Bill. This problem of low feed grain prices should correct itself in the next year or two. The other cause of surpluses was the Class I price increases included in the 1985 Farm Bill. These discriminatory, non-economic, politically motivated increases may be difficult to roll back resulting in permanent injury to the dairy industry.

We, in the Midwest, have had about as much help from Congress as we can stand.

The use of a market oriented formula as recommended by the Dairy Policy Commission should not be adopted. The market place should determine the level of price supports. If the marketplace doesn't absorb the supply produced at a given price support level, the price support level should be dropped. If the level of support purchases drops below 3 or 4 billion pounds the price support level should be increased.

Some type of stand-by production control program may be necessary on a temporary basis but preferably not the whole herd buy-out or the two tier pricing system as recommended by the Dairy Policy Commission. It should be a diversion type program that provides a safety net or alternative for all producers when price supports are lowered.

The whole herd buy-out type of program can be criticized in the following respects:

1. It provides a retirement program for older dairy farmers who would have gotten out of dairying anyhow.
2. It provides lenders an opportunity to re-coup farm indebtedness of financially strapped farmers.
3. It discriminates against traditional dairy production regions such as the Northeast and Midwest who have sizeable investments in buildings and machinery. Other areas which purchase feed supplies, hire help and have little building investment due to climate, can get into and out of dairying much faster and with less jeopardy to their investments.
4. Liquidation of entire herds to reducd production to a given level means that fewer farmers can participate than if a larger number of producers curtail production 5-30% to reduce surpluses to acceptable levels.
5. The WHB does not provide a safety net on a voluntary basis for all farmers which is desireable when price supports are lowered.
6. The WHB took a lot of efficiency out of the dairy industry by slaughter of high producing cows as well as low producing cows.

The two-tiered pricing system can be criticized in the following respects:

1. It is mandatory rather than voluntary.
2. It involves a lot of red tape and high administrativr costs.
3. It represents too much Government regulation in the eyes of producers and consumers. We need less Government regulation, not more.
4. Even as a stand-by program it would encourage some farmers to race for base.
5. It could lead to a permanent quota system with all it's shortcomings including value of bases becoming capitalized into the cost of production and freezing of production patterns.

WHAT TYPE OF LEGISLATION IS NEEDED

1. The discretionary level of 5 billion pounds and mandatory level of 7 billion pounds for implementing a production control program is OK. The implementation of such a program should be accompanied by a step-wise (dated) reduction in price supports of 50¢/cwt.
2. The production control program should be a diversion program or combination diversion-buy-out program instead of WHB or

two tiered pricing. The arguments for a diversion program are:

1. It offers a safety net to accompany reductions in price-support rates. It is available to all farmers regardless of circumstances.
2. It is voluntary
3. If farmers have the opportunity to decrease production 5-30% instead of 100% as in the WHB program:
   a. More farmers can participate
   b. Farmers can increase production efficiency thus survive a lower price level in the future by culling their poorest cows.
4. The program has a lot of flexibility. For example: the payment rate for reducing production can be set at any desired rate, say \$8-\$10/cwt.. to get the desired level of participation.

   If farmers sign up to participate at a higher level than desired, contracts on volume can be cut back on an equal percentage to arrive at an objective cut-back figure nationally.
5. It avoids the buying out of retiring farmers and bailing out creditors.
6. The participation and payments would help the financial status of all farmers. For example: a payment of \$10.00 per cwt. to reduce production exceeds the marginal income derived if the farmer had produced the milk. The Government would save about \$17.00/cwt. in not having to purchase surplus products.

The diversion program was criticized before because it did not result in less young stock being kept or a reduction in cow numbers. A new diversion program could contain a stipulation that if a farmer signed up to reduce production 5-30% it must be accompanied by a 5-30% reduction in cow numbers including youngstock. This would eliminate farmers circumventing the purpose of the diversion program by feeding less or building up youngstock numbers.

In summary make the new legislation simple and effective. In no case regionalize the price support and/or supply control programs. This would be a great disservice to our national dairy industry and the consuming public.

THE GAO REPORT ON FEDERAL MILK MARKETING ORDERS

Most of the observations and conclusions and recommendations presented in the GAO report are correct. Because they are economically sound, Congress should exert pressures and legislation to effectuate needed changes in the Federal Milk Marketing program. If Congress acceeds to political pressures to do nothing they will cause a major dislocation of national resources by ignoring economics based on free competition,market driven pricing and comparative advantage.

There is no doubt that the following conclusions reached by GAO in regard to Federal Milk Marketing Orders are correct.

1. They have contributed to excess production.
2. They have treated some producers unfavorably compared to others.
3. Milk is produced in all regions of the country and technologies are available to transfer it, either as fluid or in a form later to be reconstituted as fluid, should local shortages develop.
4. Grade "A" differentials are too high relative to the price of Grade "B" milk.
5. Distance differentials (based on shipping whole milk from Eau Claire) are no longer appropriate because they do not show a constant relationship to regional variations in the cost of production or of obtaining supplies from alternative sources.
6. Down allocations and compensatory payments prohibit the use of reconstituted milk to efficiently move milk to deficit markets.

These observations and conclusions should be taken seriously by Congress and those who administer the Federal Order program because the dairy industry is building on the false footings of political acceptability or expediency rather than sound economics. This does irreparable harm to producers, handlers, investors, tax payers and consumers.

Criticisms levelled at the Federal Milk Marketing Order progeam are real. They are not due to flaws in the Ag. Adjustment Act of 1937 which gave birth to Federal Orders. They are due to how Federal Orders are developed and administered.

For example: The obsolete concept of pricing milk at Eau Claire plus the cost of transporting milk to the South and East is an administrative concept not specified in the Ag.Adjustment Act. The presense of compensatory payments and down allocation provisions for reconstituted milk is an administrative decision based on politics. The level of Class I differentials is an administrative one. The slow rate of consolidating Orders into Regional Orders is an administrative decision.

Those who administer Federal Orders excuse their inaction by saying Coops. or producers are not asking for such changes. Why would any producer group in any Federal Order ask for consolidation, elimination of down allocation and compensatory payments on reconstituted milk or lower ClassI differentials when it may not be in their own best interests.

So the administrators of Federal Orders acceed to local interests vs. the national dairy industry and consumer interests. We have a situation where Coops. support Federal Orders and Federal Orders support Coops., and to Hell with what is good for the dairy industry as s whole and the consuming public.

The Ag. Adjustment Act of 1937 specifically states in 8C5G that Federal Orders shall not prohibit the marketing of milk or any products thereof from any production area of the U.S. So the compensatory payment and down allocation provisions are in direct violation of the Act. At one time there were such provisions against whole milk in Federal Orders which were eliminated by the Lehigh Valley case.

CONGRESSIONAL ACTION NEEDED

What should Congress do to put the Federal Orders back on sound economic footing? I think they should do the following:

1. Pressure USDA to eliminate down allocation and compensatory payment provisions on Grade "A" powder or condensed milk that is reconstituted in the receiving market and is pooled and priced as Class I in the shipping market. In other words, treat powder or condensed milk the same as whole or skim milk.

   A simple law by Congress to this effect would solve this problem. This eventually would lead to a more realistic alignment of Class I prices between the Midwest, East and South. The new price alignment would be Midwest Class I price plus powder processing costs plus powder transportation costs.
2. Roll back the Class I differential price increases granted in the 1985 Farm Bill. They made no economic sense, were discriminatory against the Midwest and are causing surpluses in many high cost of production areas.
3. Encourage USDA to hasten consolidation of Federal Orders via decree or law. USDA doesn't want to move because jobs are involved. Producers with certain local market advantages won't move to consolidate orders. Therefore Congressional pressure or law is necessary to speed up consolidations in the interest of producers, handlers and the consuming public.

These few recommendations if adopted would be sufficient to put the Federal Order program back onto firmer ground economically in the best interests of all producers and consumers. Other recommendations of GAO may have some validity in the long run but cannot be achieved in the near future due to Federal Order characteristics, personalities and politics.

The three recommendations for Congress are achievable and will go far in correcting the economic deficiencies presently found in Federal Milk Marketing Orders.

Your consideration of this testimony is greatly appreciated.

Sincerely,

Robert J. Williams

Robert J. Williams
Executive Director-T.A.P.P.

THE NATIONAL DAIRY PROGRAM

The Dairy Farm Protection Act (S. 1869) and Milk Marketing Orders

WEDNESDAY, MAY 11, 1988

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 10:15 a.m., in room SR-332, Russell Senate Office Building, Hon. Patrick J. Leahy (chairman of the committee) presiding.

Present or submitting a statement: Senators Leahy, Conrad, Daschle, Lugar, Boschwitz, and McConnell.

Also present: Senator Kasten.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. I want to welcome everyone to this second hearing on our national dairy program. Today, we will hear, of course, first from Senator Kasten, who is no stranger to this committee. He has been here a number of times before and has worked with the committee on a number of agriculture issues, especially dairy. I also want to note that Commissioner Butcher from New York is here and I am delighted to see that because I know he has been working with Commissioner Allbee of Vermont on a number of dairy issues, especially RCMA and the regional compact.[1] In fact, he has been working on my regional dairy bill also. I am glad, Commissioner, you are here today.

We look forward to Commissioner Butcher's remarks because we are going to be discussing the regional differences and milk marketing orders, and how they are applied.

A lot of the farmers in the Northeast feel the current program is not fair, and I have to think that maybe they are right. Through March, the Northeast milk production has not increased at all compared to last year. Contrast that to Texas and Idaho—both up 11 percent in March, California—up 6 percent, Washington State—up 4 percent. Minnesota, however, is up only 1 percent. So that is why I introduced the Dairy Farm Protection Act, S. 1869, to address that growing imbalance of milk production in this country.

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[1] A proposal to establish a Northeast Interstate Dairy Compact. The focus of the effort has been with the States of Vermont and New York and particularly with legislative leaders of those two States.

I would like to see the country divided into basic milk producing regions with sales to CCC in excess of a base sales level funded by producers in the individual regions. That way price cuts would not be put on the whole country just because of overproduction in one part of the country.

If we accept the idea that we should have dairy production possible in all parts of the country, we have to do it this way. If we decide that we want to have dairy production only in one or two parts of the country, and the rest supplied by exports from outside the country, then we do not need to do anything. But I do not really think that is the feeling in this country.

The bill was introduced to stimulate debate, and I am open to any ideas, especially as we start thinking about the 1990 farm bill. And I am glad to see some new ideas, new approaches are beginning to come forth. There was the "Cheese Market News" article about what to do with extra butterfat as consumers' tastes change.

There is the possibility of adjustments in market orders and recognition of the importance of dairy products in nutrition programs.

These are all ideas, I think, that have been stimulated by the debate and the concern that is felt around the country. I wish the Dairy Policy Commission had addressed such forward thinking issues as this. In addition to regional issues, we will focus on milk market orders.

They are very complex regulations. There are only three people in the whole nation who fully understand them, and they are not allowed to talk. I know that issue is important to Senator Boschwitz as well as others from the Upper Midwest.

While I share his concern about the growth in milk production in Texas and other areas with high Class I differentials, I want him to know that in Vermont we need a higher Class I differential just to keep our dairy farmers in business. I again point out that the Northeast production is not growing.

I think GAO has failed to realize the realities at the retail level. Milk prices are lower in Maine, for example, than they are in Minneapolis. Would removal of distance differentials help the consumer? A valid question.

So we will work with Senator Lugar, Senator Boschwitz, and others on this committee, to develop new, innovative ideas to protect farm income. We want to support a viable dairy industry across the country.

We want to place responsibility of surplus disposal on those who produce the surplus; target benefits to the family dairy farm; recognize the Federal budget restraints. Some of those ideas may sound as though they are contradictory. I do not think that is so.

I think that one of the reasons for having these hearings is the fact that we recognize these problems, and we want to solve them. But I would just state and summarize that it is my intention to try to find legislation which says that it would be possible for a viable dairy industry in all the major parts of the country, not just in one or two and to be able to supply all our dairy needs by indigenous U.S. dairy industry and not have to rely on imports from other parts of the world.

I yield to the distinguished Senator from Indiana.

[The prepared statements of Senator Leahy and Senator McConnell follow:]

Statement of the Honorable Patrick J. Leahy, Chairman, Committee on Agriculture, Nutrition, and Forestry

Hearing on S. 1869 and Milk Marketing Orders
May 11, 1988

I want to welcome everyone to this second hearing on our National Dairy Program. Today, we will look at regional problems in the dairy industry and milk marketing orders.

As many of you know, I introduced a bill last year, the "Dairy Farm Protection Act", which is designed to redress a growing imbalance in milk production in this country.

The farmers of Vermont feel that the current program is not fair to them...and they are right. While our milk production is holding steady, we see great expansion in Texas and Idaho--both up 11 percent in March, California--up 6 percent, Washington State--up 4 percent. The list could go on. Production growth in the Northeast is flat. But even though Northeast dairy farmers are not overproducing, they are going to be penalized as if they were.

My Dairy Farm Protection Act has a simple message: if you produce a surplus then you should pay for it.

My bill would divide the Nation into basic milk producing regions. If the producers in the region started to sell more milk to the CCC than in a base period, then the producers only in that region would pay a charge to cover the cost to the CCC to take that milk off the market.

Price support cuts would no longer be used to control production. So if you are a dairy farmer in a region which had no increase in sales to the Government, then you could continue to run your business with no further price cuts.

I introduced this bill to get a debate going. And I am glad to see that new ideas, new approaches are beginning to come forth. Another idea I think we need to consider is what do we do with our extra butterfat as consumers' tastes change. This was pointed out in an article by Jim Tillison entitled "What to do with Butterfat" which was in the April 29, 1988 edition of "Cheese Market News." I wish the Dairy Policy Commission had addressed such forward thinking issues as this.

Today you will also be challenged by the recent General Accounting Office study of market orders. I know that this issue is very important to Senator Boschwitz and others from the Upper Midwest.

While I share his concern about the growth in milk production in Texas and other areas with high Class I differentials, I want him to know that in Vermont we need a higher Class I differential just to keep our dairy farmers in business. We are not expanding...we are just trying to hold our own.

I also question GAO's position that removal of ystance differentials would lower prices to consumers. Retail milk prices are actually lower in Bangor, Maine than they are in Minneapolis, Minnesota.

GAO wants to kill the whole market order system. Not on my watch. Not if it will hurt Northeast dairy. Market orders serve a purpose. They may have problems, but totally scrapping the orders can only be done in the context of a major overhaul of the entire Dairy Program.

I do hope to work with Senator Boschwitz and all members of this committee to develop new and innovative ideas for dairy. I am open to all approaches...and my goals are clear.

We need a dairy policy that will:

- Protect farm income and support a viable dairy industry across this country;
- Place the responsibility of surplus disposal on those who produce the surplus;
- Reflect Federal budget constraints; and
- Target benefits to the family dairy farm.

I look forward to today's testimony.

STATEMENT OF SENATOR MITCH McCONNELL

HEARING ON S. 1869, THE DAIRY FARM PROTECTION ACT

MAY 11, 1988

Mr. Chairman:

I would like to begin by thanking the Senator from Vermont for his continued leadership in focussing the attention of the Agriculture Committee on the issue of our federal dairy program. As I have said before, I think that the dairy policy debate has the potential for being the most devisive of the farm bill revisions coming up in 1990. As a result, I think it is imperative that we continue to give serious scrutiny to various policy options now, so that our decisions in the coming months on national dairy policy will truly be informed decisions.

I have the distinct priviledge of welcoming a fellow Kentuckian to the Agriculture Committee today. Dr. Al Ortego hails from my home town of Louisville and is here representing Dairymen, Inc. Al is indeed an authority on the dairy industry, and will serve as an excellent resource for this committee. I certainly look forward to his testimony, and thank him for taking the time to meet with us today..

The Dairy Farm Protection Act will no doubt be the focus of a great deal of discussion in the coming months. I think Senator Leahy's proposal is an interesting one, and takes into consideration one of the fundamental elements of this industry which has recently emerged to become a factor for policymakers attention, that being its regional character.

The distinguished Senator from Vermont's legislation has made clear the sharp divisions within the dairy industry about what the appropriate federal dairy policy should be. The regional nature of the growth of dairy production will no doubt be a driving force in the farm bill debate. I think that today's hearing will be useful in focussing the committee's attention on some of the details of S. 1869, and their implication for all sectors of this nation's dairy industry.

I will be particularly interested in learning of some of the witnesses thoughts on how this bill would be implemented. What will be the impact on milk deficit areas such as the Southeastern United States? Are there adjustments which could be made in our current milk marketing order system to address the problems we face? I think these are all issues which must be addressed before we begin any formal discussion in the context of the 1990 farm bill.

Dairy production is a major sector of Kentucky's agricultural economy. As a result, I want to be certain that this committee's efforts are cautious and prudent, and that the long-term interest of Kentucky's, as well as the entire nation's, dairy industry is safeguarded.

I thank the Chair.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA

Senator LUGAR. I want to thank you, Mr. Chairman. I simply join you in welcoming those who have come today to talk about the dairy industry. This is such an important part of American agriculture.

The oversight role of this committee with regard to the dairy industry is an obvious role that we ought to play, and under your chairmanship we have been playing this vigorously. I applaud your innovations and those of others who are attempting to bring some further hope, maybe even relief to the industry, and I will look forward to hearing from our colleague from Wisconsin this morning as always. Thank you.

The CHAIRMAN. And before we go to Senator Kasten, I did not know whether the very distinguished Senator from Minnesota, who once again has graced us with his presence, has anything he would like to say.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM MINNESOTA

Senator BOSCHWITZ. I am looking forward to this hearing. I thought I just heard you say we should cut off all imports. Is that what you said, Mr. Chairman?

The CHAIRMAN. No, no, no. Just those from Minnesota. [Laughter.]

That is in another bill that we are going to mark up some day when you are out of town. But I was just saying I thought we would want to continue to provide what dairy needs we might have in this country without finding ourselves in a position where maybe a decade down the road our dairy needs will be supplied by maybe just one or two parts of the country and imports from other countries.

This is an area where we should, and with any kind of planning, should be in a position where we can always supply all our dairy needs indigenously and without having to have imports and without having to have tariffs or barriers as we now do.

Senator BOSCHWITZ. That will be an interesting combination of circumstances if we can pull it off, Mr. Chairman. But I do compliment you for holding this hearing on marketing orders. It really is an important hearing. The marketing orders were devised many years ago for sensible reasons in order to assure an adequate supply of milk in various parts of the country. And now because the marketing orders, the pricing aspects of them at least, including a very large Class I and Grade A differential, we are shifting dairy production around and penalizing some parts of the country that really cannot do much else with their land other than raise ruminant animals.

It is important that we look at this carefully. Some portions of the marketing orders are certainly worthwhile. They make up an important element of dairy grading and marketing, but some aspects of this, I think, should be subject to revision. So I am delighted that you are holding the hearing.

The CHAIRMAN. I think they are. The New England order alone is more than 120 pages, and it has the freight zones in it. The city I live in, Burlington, has a different zone than South Burlington. There is no way of telling which zone you are in. I mean, one side of the street is South Burlington. The other side is Burlington. It is not something that is separated by an obvious geographical line, a mountain, or something like that. But anyway we are delving into Senator Kasten's time and testimony. And we welcome you here. You represent one of the great dairy producing States, and your input has always been valuable. I yield to you.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM WISCONSIN

Senator KASTEN. Mr. Chairman, thank you very much. I thank you first of all for calling this hearing on Federal dairy policy. I would like to summarize my remarks, and submit my full statement for the record.

The General Accounting Office report on milk marketing orders demonstrates something that we in Wisconsin have known for some time—Federal milk marketing orders are outdated. The enormously complex system of milk pricing regulations the order provide is simply not needed to assure consumers an adequate supply of milk today.

The arbitrary increases in guaranteed Class I (fluid) prices in the 1985 farm bill have helped cause an explosion of unneeded milk production in Texas, and very substantial increases in Florida and other Southern States.

The statistics on milk production and dairy cow numbers that I have attached to my prepared statement show clearly that, while all producers have been getting more milk production per cow, producers who have been expanding by adding cows are concentrated in the South and in the West. Already gaining by the cheap corn supply created by the 1985 farm bill, farmers in Texas got a bonus of almost a dollar per hundredweight through the Class I differential increase in that legislation.

The production increases are a direct result of that. It would be fine if we needed the milk, but we do not. Wisconsin and Minnesota, as my colleague from Minnesota well knows, together have about one-quarter of the Nation's dairy farmers. Those two States, plus New England and the States in between, have well over 60 percent of the country's dairy farmers.

A Government policy that encourages production in the South takes markets away from Wisconsin farmers and lowers their price. Thanks in part to milk marketing orders, that price is already lower than that offered dairy farmers anywhere east of the Rockies. Farmers in Wisconsin think this is unfair, and I believe that they are right.

The GAO report evaluates several proposals to change the orders. The changes aim at deregulation—a sensible direction in the case of any government intervention in the economy the purpose of which is no longer clear.

I endorse a number of these options, specifically, the elimination of distance differentials and the restrictions on the pricing of reconstituted milk.

When I discuss trade with constituents from Wisconsin, I frequently hear Wisconsin businessmen say that they can compete with foreign businesses, but they cannot compete with foreign governments.

Well, the dairy industry produces for the domestic market, and the Government that intervenes in the market is our own, but the principle is the same. The GAO report's conclusion is right on target, and I quote: "The milk marketing order system should be changed because its provisions have contributed to excess production and treat some producers unfavorably compared with others."

No one has presented any evidence that, under modern conditions, massive Federal intervention in dairy markets is necessary to assure an adequate supply of milk.

This is a point worth noting, with regard to Western States which are not affected by Federal orders. Farmers in these States have very low production costs and they also have limited nearby markets. Given their low production costs, they can easily serve these markets, but expansion makes no sense unless another market exists.

That other market is the Federal price support program. By providing a guaranteed market for surplus production, the price support program virtually eliminates risk. The result: massive expansion in the industry on the west coast.

Under current policy, increasing CCC purchases of dairy products on the west coast will all but guarantee an additional price support reduction of 50 cents on January 1. This cut will hit hardest in the Upper Midwest, but will also impact on New England and other areas. The industry on the west coast, however, will continue to expand, using a guaranteed minimum price still well in excess of their production costs.

The point I want to make is simple. Dairy is unique in some ways, but in one sense it is just like cotton or rice or citrus fruits—it is more important to some parts of the country than it is to others. Federal dairy policy needs to reflect this fact. If milk marketing orders are not helping farmers in the major dairy areas, they ought to be phased out.

If the dairy price support program is leading to the replacement of family farms in Wisconsin, in Minnesota, in Vermont, with the thousand-cow milk factories on the west coast, we ought to look at helping the dairy farmer in some other way.

One option might involve targeting assistance to dairy farmers by way of deficiency payments, the way we do with the major program crops. There may be other ideas. But the National Commission on Dairy Policy Report which offers lower milk prices to the States that have the most dairy farmers is not acceptable.

If we are to devise a market oriented policy that promotes the interest of the greatest number of dairy farmers, I believe we must do better, and I believe, Mr. Chairman, that we can.

[The prepared statement and attached tables of Senator Kasten follow:]

STATEMENT BY
THE HONORABLE ROBERT W. KASTEN, JR.
SENATE COMMITTEE ON AGRICULTURE
APRIL 28, 1988

Mr. Chairman, and members of the Committee, I thank you for calling this hearing on federal dairy policy today, and for allowing me an opportunity to give my views on this subject.

As you know, Mr. Chairman, Wisconsin has more dairy farmers than any other state. We have more dairy plants than any other state -- we produce more milk, more cheese, and more butter than any other state.

About 60% of farm income in Wisconsin -- about $3 billion -- comes from the sale of milk. Something like half of the remainder comes from the sale of corn, hay, cattle for beef, veal calves, and other products related to the dairy industry.

Because dairy is so vitally important to my state, Mr. Chairman, I commend you for holding this hearing on the General Accounting Offices Report on milk marketing orders.

East of the Rocky Mountains, federal milk marketing orders regulate the pricing of milk used as fluid, or beverage, milk. First established half a century ago, their objective was to assure consumer a supply of milk by encouraging local milk production at a time when fluid milk could not be easily transported across long distances.

The GAO Report demonstrates what we in Wisconsin have known for some time -- federal milk marketing orders are outdated. The enormously complex system of milk pricing regulations the order provide is simply not needed to assure consumers an adequate supply of milk.

Furthermore, the record clearly demonstrates that while the orders may have been intended originally to protect farmers, they are not doing that now. Instead, the arbitrary increases in guaranteed Class I (fluid) prices in the 1985 farm bill have helped cause an explosion of milk production in Texas, and very substantial increases in Florida and other Southern states.

Mr. Chairman, I have attached to my statement two tables showing, respectively, milk production and dairy cow numbers in the continental United States. In the last column of each of these tables is a number showing the percentage increase or decrease in each state, adjusted for the buyout. In other words, these tables show what non-participants in the dairy buy-out and new dairy farms did between 1985 and 1987.

I ask that these tables appear in the record at this point.

These tables show clearly that while most states have increased production (adjusted for the buy-out) the largest increases have taken place in the South and West -- and that these areas have added thousands of cows, while cow numbers in the traditional northern dairy states have declined or remained stable.

There are many factors in dairy economics, but it is clear that the legislated increase in the guaranteed minimum price for farmers in Texas has been a major factor in the explosive growth of milk production in that state.

Having said that, I want to draw the Committee's attention to the fact that most dairy farmers still live and work in the traditional northern dairy states. Wisconsin and Minnesota together have about 1/4 of the nation's dairy farmers. Those two states, plus New England and the states in between, have well over 60% of the country's dairy farmers.

In the Upper Midwest especially, a government policy that encourages production in the South takes markets away from our farmers and lowers their price. Thanks in part to milk marketing orders, that price is already lower than that offered dairy farmers anywhere east of the Rockies.

In effect, milk marketing orders are taking markets away from the family farmers of my state, and giving them to wealthy people milking hundreds or thousands of cows in Texas and Florida. Farmers in Wisconsin think this is unfair, and they are right.

The GAO Report evaluates several proposals to change the orders. The changes aim at deregulation -- a sensible direction in the case of any government intervention in the economy the purpose of which is no longer clear.

I endorse some of these options -- specifically, the elimination of distance differentials and the restrictions on the pricing of reconstituted milk. Indeed, I tend toward the view that elimination of the pricing provisions of the orders generally would be in the best interest of those states to which the dairy industry is most important.

I realize that powerful interest groups like the orders the way they are. The current regulatory system provides a predictable environment for some fluid milk processors, both proprietary (pro-PRY-etary) plants and those owned by cooperatives. These same cooperatives have also made clear their interest in increasing milk production in Texas and other southern states.

Maintaining a totally predictable business environment for processors and promoting unneeded milk production are not compelling federal interests. Since the pricing provisions of the orders serve no other purpose, we ought to work toward phasing them out.

Mr. Chairman, when I discuss trade with constituents from Wisconsin, I frequently hear that Wisconsin businesses can compete with foreign businesses -- but they can't compete with foreign governments.

Well, the dairy industry produces for a domestic market, and the government that intervenes in that market is our own, but the principle is the same. The GAO Report's conclusion is right on target, and I quote:

> The milk marketing order system should be changed because its provisions have contributed to excess production and treat some producers unfavorably compared with others
>
> ...the premises for milk pricing under federal orders are outdated. A need no longer exists to encourage and maintain a locally produced supply of milk. Milk is produced in all regions of the country, and technologies are available to transfer it, either as fluid or in a form to be later reconstituted as fluid, should local shortages develop.

Mr. Chairman, I would like to close with the observation that no one has presented any evidence that, under modern conditions, massive federal intervention is necessary to assure an adequate supply of milk.

This is a point worth noting with regard to California and other western states, which are not effected by federal orders. Farmers in these states have very low production costs, due partly to federal water subsidies -- and they also have limited nearby markets. Given their low production costs, they can esaily serve these markets, but expansion makes no sense unless another market exists.

The other market is the federal price support program. By providing a guaranteed market for surplus production, the price support program has encouraged massive expansion in the industry on the West Coast. USDA figures indicate that California has sold up to 15% of its production to the government -- and in Washington the figures has gone as high as 40%.

Under current policy, increasing CCC purchases of dairy products on the West Coast will all but guarantee an additional price support reduction of 50 cents on January 1st. This cut will hit hardest in the Upper Midwest, but will also impact New England. The West Coast, however, will continue to expand, using a guaranteed minimum price still well in excess of their production costs.

It would be one thing if this expansion resulted from commercial activity -- instead, it is made possible by the government program.

This reality makes me look askance at the report of the Dairy Policy Commission, with its recommendation for business as usual. The Commission appears to have made its objective achieving a compromise among factions in the dairy industry, rather than serving the interests of the greatest number of dairy farmers.

Mr. Chairman, the point I want to make is very simple. Dairy is unique in some ways in agriculture, but in one sense it is just like cotton or rice or citrus fruits -- it is more important to some parts of the country than to others.

While achieving "unity" within the dairy industry may bring psychological satisfaction to some people, as far as I am concerned it is beside the point. The Dairy Commission Report offers lower milk prices as far as the eye can see to the states that have the most dairy farmers.

This is not acceptable to Wisconsin. I doubt whether it would be acceptable in Vermont either. If we are to devise a market-oriented policy that promotes the interests of the greatest number of dairy farmers, I believe we must look at a fundamental overhaul of dairy policy.

Just like other farm programs, the point of the dairy program ought to be to help farmers. Perhaps the best way to do that is target assistance to them directly.

Mr. Chairman, I thank you for this opportunity to present my views.

The tables referred to follow:

		- - - - - - - - - - - MILK PRODUCTION	- - - - - - - - - - -			
		1985	TOTALS...	1987 TOTAL	..BUYOUT ADJUSTED...	
STATE	REGION	ALL PRODUCERS (MIL. LBS)	BUYOUT PARTICIPANTS (MIL. LBS)	ALL PRODUCERS (MIL. LBS)	CHA NGE (MILLION POUNDS)	(PCT. OF '85 TOTAL)
	NORTHEAST					
CONN	1	620	73	567	20	3.23%
DEL	1	147.1	7	139	-1.1	-0.75%
MAINE	1	673	73	671	71	10.55%
MASS	1	595	110	504	19	3.19%
MD	1	1625	124	1508	7	0.43%
N H	1	364	53	323	12	3.30%
N J	1	487	32	432	-23	-4.72%
N Y	1	11731	470	11362	101	0.86%
PA	1	9983	271	10183	471	4.72%
R I	1	44	2.2	40	-1.8	-4.09%
VT	1	2410	169	2410	169	7.01%
	APPALACIA					
KY	2	2222	199	2338	315	14.18%
N C	2	1748	218	1555	25	1.43%
TENN	2	2235	190	2207	162	7.25%
VA	2	2102	197	2016	111	5.28%
W VA	2	382	45	349	12	3.14%
	SOUTHEAST					
ALA	3	547	128	502	83	15.17%
FLA	3	2038	283	2209	454	22.28%
GA	3	1300	278	1155	133	10.23%
S C	3	584	74	547	37	6.34%
	LAKE STATES					
MICH	4	5568	638	5248	318	5.71%
MINN	4	10840	968	10436	564	5.20%
WIS	4	24700	785	24800	885	3.58%
	CORN BELT					
ILL	5	2721	166	2775	220	8.09%
IND	5	2415	175	2415	175	7.25%
IOWA	5	4058	348	3550	-160	-3.94%
MO	5	2870	405	2900	435	15.16%
OHIO	5	4870	264	4810	204	4.19%
	DELTA					
ARK	6	848	171	748	71	8.37%
LA	6	911	83	877	49	5.38%
MISS	6	876	148	786	58	6.62%
	NO.PLAINS					
KANS	7	1285	158	1241	114	8.87%
N DAK	7	1120	135	1103	118	10.54%
NEBR	7	1340	158	1340	158	11.79%
S DAK	7	1781	208	1759	186	10.44%
	SO.PLAINS					
OKLA	8	1183	162	1170	149	12.60%
TEX	8	3968	637	4300	969	24.42%
	MOUNTAIN					
ARIZ	9	1348	138	1432	222	16.47%
COLO	9	1105	115	1192	202	18.28%
IDAHO	9	2421	516	2375	470	19.41%

STATE	REGION	- - - - - ....1985 ALL PRODUCERS (MIL. LBS)	- - - - - TOTALS... BUYOUT PARTICIPANTS (MIL. LBS)	MILK PRODUCTION 1987 TOTAL ALL PRODUCERS (MIL. LBS)	- - - - ..BUYOUT ADJUSTED... CHANGE (MILLION POUNDS)	- - - - - - (PCT. OF '85 TOTAL)
MONT	9	349	41	331	23	6.59%
N MEX	9	1078	159	979	60	5.57%
NEV	9	266	4	278	16	6.02%
UTAH	9	1135	184	1121	170	14.98%
WYO	9	134	22	120	8	5.97%
	PACIFIC					
CALIF	10	16768	1779	17934	2945	17.56%
OREG	10	1438	176	1471	209	14.53%
WASH	10	3750	540	3763	553	14.75%
US TOTAL	50 STATES	143147	12280	142462	11595	8.10%
ALASKA		22.2	0	34.8		
HAWAII		142	0	156		
US TOTAL	48 STATES	142982.8	12280	142271.2	11568.4	8.09%
SUM	48 STATES	14298[illegible].1	12279.2	142271	11567.1	8.09%
DIFF		-0.3	0.8	0.2	1.3	0.00%
REGIONS:						
NORTHEAST	1	28679.1	1384.2	28139	844.1	2.94%
APPALACHIA	2	8689	849	8465	625	7.19%
SOUTHEAST	3	4469	763	4413	707	15.82%
LAKE STATES	4	41108	2391	40484	1767	4.30%
CORN BELT	5	16934	1358	16450	874	5.16%
DELTA	6	2635	402	2411	178	6.76%
NO. PLAINS	7	5526	659	5443	576	10.42%
SO. PLAINS	8	5151	799	5470	1118	21.70%
MOUNTAIN	9	7836	1179	7828	1171	14.94%
PACIFIC	10	21956	2495	23168	3707	16.88%
		142983.1	12279.2	142271	11567.1	8.09%

		- - - - - -	- - - - NUMBER OF MILK COWS - - - - - -	- - - - - -	- - - - - -	- - - - - -
		1985	TOTALS...	1987 TOTAL	..BUYOUT ADJUSTED...	
		ALL	BUYOUT	ALL	CHA NGE	
STATE	REGION	PRODUCERS (1000'S)	PARTICIPANTS (1000'S)	PRODUCERS (1000'S)	(1000'S)	(PCT. OF '85 TOTAL)
	NORTHEAST					
CONN	1	47	5.321	39	-2.679	-5.70%
DEL	1	10.3	0.617	9.5	-0.183	-1.78%
MAINE	1	55	5.612	49	-0.388	-0.71%
MASS	1	47	8.117	35	-3.883	-8.26%
MD	1	123	9.254	114	0.254	0.21%
N H	1	29	3.869	24	-1.131	-3.90%
N J	1	38	2.453	33	-2.547	-6.70%
N Y	1	948	34.858	858	-55.142	-5.82%
PA	1	740	20.614	721	1.614	0.22%
R I	1	3.5	0.176	2.9	-0.424	-12.11%
VT	1	183	13.268	174	4.268	2.33%
	APPALACIA					
KY	2	231	19.064	218	6.064	2.63%
N C	2	128	16.381	110	-1.619	-1.26%
TENN	2	210	16.575	203	9.575	4.56%
VA	2	164	15.437	145	-3.563	-2.17%
W VA	2	34	3.480	32	1.48	4.35%
	SOUTHEAST					
ALA	3	49	11.667	40	2.667	5.44%
FLA	3	173	23.329	177	27.329	15.80%
GA	3	117	24.419	99	6.419	5.49%
S C	3	48	5.947	44	1.947	4.06%
	LAKE STATES					
MICH	4	394	46.146	361	13.146	3.34%
MINN	4	915	79.597	823	-12.403	-1.36%
WIS	4	1876	62.633	1795	-18.367	-0.98%
	CORN BELT					
ILL	5	227	13.723	212	-1.277	-0.56%
IND	5	202	13.859	194	5.859	2.90%
IOWA	5	352	30.275	302	-19.725	-5.60%
MO	5	232	36.974	221	25.974	11.20%
OHIO	5	388	20.312	370	2.312	0.60%
	DELTA					
ARK	6	80	16.080	64	0.08	0.10%
LA	6	96	8.003	88	0.003	0.00%
MISS	6	87	14.351	72	-0.649	-0.75%
	NO.PLAINS					
KANS	7	113	13.284	105	5.284	4.68%
N DAK	7	101	13.213	93	5.213	5.16%
NEBR	7	109	14.109	102	7.109	6.52%
S DAK	7	162	18.951	148	4.951	3.06%
	SO.PLAINS					
OKLA	8	110	14.547	109	13.547	12.32%
TEX	8	319	54.986	329	64.986	20.37%
	MOUNTAIN					
ARIZ	9	86	6.773	90	10.773	12.53%
COLO	9	78	8.382	75	5.382	6.90%

		- - - - - - - - - - NUMBER OF MILK COWS - - - - - - - - - -				
		1985	TOTALS...	1987 TOTAL	..BUYOUT ADJUSTED...	
					CHA NGE	
STATE	REGION	ALL PRODUCERS (1000'S)	BUYOUT PARTICIPANTS (1000'S)	ALL PRODUCERS (1000'S)	(1000'S)	(PCT. OF '85 TOTAL)
IDAHO	9	170	34.425	159	23.425	13.78%
MONT	9	28	2.845	25	-0.155	-0.55%
N MEX	9	67	10.189	58	1.189	1.77%
NEV	9	18.8	0.223	19	0.423	2.25%
UTAH	9	83	14.010	74	5.01	6.04%
WYO	9	11.6	1.734	9.7	-0.166	-1.43%
	PACIFIC					
CALIF	10	1004	114.947	998	108.947	10.85%
OREG	10	100	12.496	92	4.496	4.50%
WASH	10	222	34.094	208	20.094	9.05%
US TOTAL	50 STATES	11016	951.619	10334	269.619	2.45%
ALASKA		1.6	0	2.3		
HAWAII		11.3	0	11.6		
US TOTAL	48 STATES	11003.1	951.619	10320.1	268.619	2.44%
SUM	48 STATES	11009.2	951.619	10323.1	265.519	2.41%
DIFF		-6.1	0	-3	3.1	0.03%
REGIONS:						
NORTHEAST	1	2223.8	104.159	2059.4	-60.241	-2.71%
APPALACHIA	2	767	70.937	708	14.937	1.56%
SOUTHEAST	3	387	65.362	360	38.362	9.91%
LAKE STATES	4	3185	188.376	2979	-17.624	-0.55%
CORN BELT	5	1401	115.143	1299	13.143	0.94%
DELTA	6	263	38.434	224	-0.566	-0.22%
NO. PLAINS	7	485	59.557	448	22.557	4.65%
SO. PLAINS	8	429	69.533	438	78.533	18.31%
MOUNTAIN	9	542.4	78.581	509.7	45.881	8.46%
PACIFIC	10	1326	161.537	1298	133.537	10.07%
		11009.2	951.619	10323.1	265.519	2.41%

The CHAIRMAN. Thank you very much, Senator Kasten, and I agree with you. I definitely think we can also. Senator Lugar, do you have any questions.

Senator LUGAR. Senator Kasten, in your thoughts as you portrayed this Western situation, are you arguing for the end of marketing orders altogether, and if so, are you arguing for a different type of program? What is the basic theme of your approach?

Senator KASTEN. I think we ought to move toward deregulating the marketing order pricing system and also toward a price that is more standard or more in line. I think the discrepancies that we see from one area of the country to another maybe were meaningful years ago.

But today, this whole transportation system has changed. The idea of having to have an adequate locally produced supply of milk in every region of the country is, I think, outdated. I think that we need to deregulate the entire system and possibly have one price across the country that would be consistent.

Senator LUGAR. Why, just for the sake of argument, would you not simply eliminate the Federal Government from this altogether and let the market work?

Senator KASTEN. I think that is something that the committee can consider and should consider. We could look at the idea of everyone, and this is ideally what we need to be doing, everybody producing for the market. But that is going to be tough to work through, and it is going to be tough to phase in.

And there are a number of questions along the way, but I think that is a reasonable goal. I think that most Wisconsin farmers would much prefer to be producing for the market as opposed to be producing for a government program.

But with these Class I differentials, we are seeing production remaining roughly the same from Minnesota and Wisconsin across to the East and to Vermont, and we are seeing huge increases in Texas and California and some of these other places. And the production resulting from those increases, in effect, is going not to the market but are going to the Federal Government program.

Senator LUGAR. Thank you.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. No, I do not think I have any questions. I would say that some elements of the marketing orders that do not deal with pricing are not quite as difficult to cope with. Certainly marketing orders have some redeeming features to them, particularly with respect to grading and so forth.

But I do agree with the Senator from Wisconsin that times have changed. The 1985 farm bill exacerbated the problem by increasing the Class I differentials rather than lessening them. They have a tendency to artificially move milk production around. Milk production is really what we should deal with. I think that is what you essentially said.

The CHAIRMAN. Senator McConnell.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Senator McCONNELL. Thank you, Mr. Chairman. I appreciate your having these hearings. I welcome Senator Kasten here. We also have coming before us shortly Dr. Albert Ortego from Louisville, my home town, who is here on behalf of Dairymen. I represent, of course, an area of the country that is milk deficient. And we are——

Senator BOSCHWITZ. Well, we will send you some.

The CHAIRMAN. We would be anxious to help you out.

Senator McCONNELL. You are doing that. In looking toward 1990, I think you all are all correct. I think it is going to be one of the most contentious sections of the next farm bill. I do not know how it is all going to be sorted out, but I do not think anybody is entirely satisfied with the way it is now. We clearly have to make some changes.

Mr. Chairman, I have an opening statement which I would like to insert in the record at the appropriate place.

The CHAIRMAN. Without objection.

[The prepared statement of Senator McConnell can be found on p. 144.]

Senator KASTEN. Mr. Chairman, I thank you for the opportunity to appear before you.

The CHAIRMAN. Thank you, Bob. I would note for the record, before we get started, that sometimes how well people are doing is reflected in the representation they have here. I come from this very poor area where I drive my 14-year-old Dodge into work and what not, and then I look at the distinguished Senator from Minnesota, and I look at his residence and his car parked.

Senator BOSCHWITZ. Well, there it is. A little picture we took in Switzerland.

The CHAIRMAN. You can keep it. It is for you.

Senator BOSCHWITZ. I am just showing it to Senator Lugar.

Senator LUGAR. Beautiful.

The CHAIRMAN. I should note before anybody gets the wrong idea, the picture is of a Rolls-Royce, but it does not really belong to the distinguished Senator from Minnesota. We live near each other and carpool back and forth on occasion. We walked by a hotel lobby and saw this Rolls-Royce parked in it and decided that is what we wanted to do our carpooling in, but could not figure out any way to explain that back home.

Senator BOSCHWITZ. I would mention to the Senator from Vermont that he has only driven me in his car, and that I purchased this vehicle and keep it in the garage now.

The CHAIRMAN. I would point out the distinguished Senator is the chairman of the Republican Senate Campaign Committee, and they could probably afford it.

Senator BOSCHWITZ. Lots of money. Lots of money. [Laughter.]

The CHAIRMAN. With that, we will hear from our next witness. Commissioner Butcher, would you please come forward and come right on up here. We welcome you here and thank you again for coming by the hearing that we had up in Vermont last year.

STATEMENT OF DONALD G. BUTCHER, COMMISSIONER OF AGRICULTURE, STATE OF NEW YORK, ALBANY, NY, ACCOMPANIED BY ROBERT SMITH, AGRICULTURAL POLICY ANALYST, NEW YORK STATE DEPARTMENT OF AGRICULTURE

Mr. BUTCHER. We enjoyed that very much.

Chairman Leahy and distinguished Members of Congress, my name is Don Butcher, and I am the Commissioner of Agriculture and Markets for the State of New York. I appreciate this opportunity to appear before you today. I really commend the committee for the efforts being made to address the concerns of American dairy farmers in the effort to develop a sound, long-term national dairy policy.

Before I get into the highlights of the testimony, I will submit for the record my prepared testimony. I would like to briefly introduce myself since I have not met all of you. For 9 years, I served as the president of an agricultural college in Morrisville, New York, the State University of New York College of Agriculture and Technology at Morrisville.

During my tenure there I took a leave to conduct the New York Agriculture 2000 project.

Senator BOSCHWITZ. Where is Morrisville?

Mr. BUTCHER. Morrisville is south of Syracuse. It is in a rural area and is the third largest dairy farming county in the State of New York. I took leave from my job as president and served for Governor Cuomo, and took a look at agriculture in the State of New York, the 16 major commodities of the State, to see what State policies needed to be developed to enhance agriculture in New York. I am proud to say that I was recently appointed by President Reagan to the National Commission on Agricultural Policy as a result of the study for Governor Cuomo. We developed a study called "Agriculture 2000," taking a look at what needed to be done to enhance agriculture in New York.

A year ago, Governor Cuomo asked me to join his cabinet as the Commissioner of Agriculture and Markets. I think one of the best kept secrets in New York is the size of agriculture. The agriculture and food business in New York State is the State's largest industry. It contributes more to the gross State product than, of course, any other single industry. It is over $30 billion a year in business. And that is larger than the gross national product of Egypt, of Ireland, or New Zealand. And I think many times it gets overshadowed because of the heavy media attention in New York City, and when you think of Wall Street, you forget that New York has the sixth largest rural population in the United States.

We are the third largest dairy industry in the United States. It is California and Wisconsin and New York. We are vitally concerned about the future of the dairy industry. The annual farm receipts for milk production in New York are about $1.5 billion. We have about 13,000 dairy farms with about $6 billion invested in their operations.

Most of our farms are family farms and all indications are that they will remain that way into the 21st century. As with farmers in other States, we have had difficult economic times in the 1980's.

With the 50-cent reduction January 1 of this year and probably another 50-cent reduction next January, we expect to see increased numbers of dairy farmers leave the business. The Dairy Termination Program had a significant impact on milk production in New York State.

While most other major producing States rebounded with increased production, as has been pointed out by Chairman Leahy earlier, the Northeast, and New York particularly, was slow in returning to previous levels. In the marketing year 1986–87, New York sales of butter and powder to the Federal Government, the CCC, were less than 1 percent of the CCC purchases. There were no CCC purchases of cheese in New York State.

In 1987 the Milk Market Administrator for Federal Order 2, that is New York and New Jersey, conducted two hearings during September and December, and invoked a call order to ensure that there was an adequate supply of fluid milk for the market. The actual implementation of the call was avoided by voluntary efforts by the Class II handlers to make available more milk for fluid use.

New York State dairy farmers and the New York State government have undertaken several initiatives to improve our situation, and I would like to share those with you today. Recently Governor Cuomo called for the development of a Net Dairy Farm Income Enhancement Program. As the first phase of this program, the Governor and legislative leaders have agreed to provide $350,000 to develop a dairy profitability and productivity project.

Another positive initiative in the Northeast is our effort to bargain for over-order prices through the Regional Cooperative Marketing Agency commonly called the RCMA. While over-order pricing has been established on Class I milk in many major market areas throughout the country, this has not happened until recently in the Northeast. In light of reductions in the Federal support price for milk, the RCMA over-order program is essential to the future of the dairy industry in New York.

Another effort to make our dairy industry competitive is the elimination of restrictive and burdensome milk dealer licensing regulations and statutes through leadership provided by Governor Cuomo during the last legislative session.

We had not made major changes in the dairy licensing laws in our State in the last 50 years. This has been a high priority for Governor Cuomo, and last year we completely rewrote the legislation regarding dairy licensing. As of April 1, 1988, we have implemented that plan, and we think that is going to really open up our markets to other States. Previously we had a restrictive county by county licensing, which we have eliminated. We have also enhanced the security for dairy farmers because we think that is important, too.

Also under review in the Northeast is a proposal to establish a Northeast Interstate Dairy Compact. The focus of the effort has been with the States of Vermont and New York and particularly with legislative leaders of those two States. The main advantages of such a compact would be:

One, to achieve complete uniformity of laws, regulations, policies, and procedures governing the production and marketing of milk in the Northeast; and two, to eliminate all duplication of licensing, producer security reports, audits and inspections.

DAIRY FARM PROTECTION ACT

To talk a little bit about the Dairy Farm Protection Act. Some of the recent proposals and discussions on national dairy policy and dairy price support programs are of utmost concern. I congratulate you, Senator Leahy, for your efforts to focus on the regional implications of the national dairy policy in the legislation you introduced, the Dairy Farm Protection Act, S. 1869.

There are differences in the dairy industry throughout the country. In fact, the Federal Government already recognizes to a certain extent that regional differences exist in the dairy industry in the United States. The USDA has administered Federal milk market orders on a regional basis throughout the United States since the 1930's.

New York and other Northeast States sell a relatively small portion of their milk marketing to the CCC. New York produced 8.2 percent of the Nation's milk supply in 1986. The State's share of CCC purchases in 1986 (butterfat basis) was 1.9 percent. So we produced 8 percent of the Nation's share and sold 2 percent to the Federal Government. This compares to California with 12 percent of the Nation's production and almost 15 percent of the CCC sales. Minnesota with 7.4 percent of the national production and almost 23 percent of the CCC purchases, and the State of Washington with 2.6 percent of the national production, and almost 9 percent of the CCC purchases. The present program which provides for support price reductions nationwide as a result of CCC purchases in certain areas of the country has serious regional implications, particularly for those areas of the country that have a relative balance between supply and demand.

Before the termination program, as a result of that, New York cut production about 8 percent. We made up 2 percent of that through expanded herds in the State. We still have a shortfall. We were pretty much in supply and demand before the termination program, and what happened is we have dropped production back 2 percent. We still have a short supply of 6 percent in the State. So there is competition for cheese, for milk, and to me it violates one of the basic rules by Samuelson when I took basic economics at Michigan State University, and that is when demand is high, supply is short, or price stays the same, that the price should go up because you have short supply. What we have now is short supply, high demand, and the price goes down. And it is very difficult for me to explain to my economic professors back in Michigan State how that happens.

But that is what is happening as a result of the 1985 farm bill. We are concerned that the present policy will temporarily solve milk surplus problems by destroying the dairy industry in the Northeast and in our State.

What we have witnessed since the whole herd buyout really does defy economic logic. For the purposes of our review of a regional support program we utilized 10 regions that were identified in a Congressional Research Service Study, and we have listed the CCC purchases into those regions with production levels, and I have included that in my testimony.

I believe this data explains the concern of many dairy farmers in the Northeast who face lower prices as a result of purchases by the CCC in excess of 5 billion pounds (milk equivalent). I fully recognize that data on CCC purchases may not always tell the full story as to where the product was produced or if milk in one region was displaced by increases in production in another region. However, it is difficult to justify the fact that the Pacific region produced less than 16 percent of the milk supply and accounted for over 40 percent of CCC purchases by the Federal Government. Less than 16 percent nationwide yet supply or sell 40 percent to the Federal Government. We believe that California and Washington State dairy interests have effectively utilized the support program to develop their dairy processing industry.

There is one aspect of the Dairy Farm Protection Act about which I want to express some concern. This legislation proposes that the average of a region's CCC sales during the past 2 years serve as the region's base. States having little or no sales during the past 2 years would get little or no base. I believe that in developing the base for such a program, consideration should be given to the possibility of a longer base period of CCC sales and should also factor in the proportion of total milk production from the region. We feel strongly that this is necessary if American dairymen and, as you have suggested earlier, in all regions are to receive equity.

NATIONAL COMMISSION ON DAIRY POLICY

Now to talk a little bit about the National Commission on Dairy Policy and our response to it. There are some recommendations in the recently released study that we support. There are also parts of the report which need further review. Let me comment briefly on some of those provisions.

MILK PRICE SUPPORT POLICY

If we are to continue a support program based on purchases, a formula should be set which would allow for appropriate adjustments to be made automatically to the support program without a decision from the Secretary of Agriculture and without congressional action.

We also support the recommendation that total adjustments in the support price not exceed 50 cents per hundredweight annually.

The recommendation to provide discretionary authority to the Secretary of Agriculture to make adjustments to the price indicated by the formula, in our opinion, is less desirable. Discretionary authority granted to the Secretary of Agriculture often leads to even greater political controversy when used in farm support programs.

The Commission's recommendation for standby authority for supply control programs seems inconsistent with the long-term objectives of the Commission. The proposal as made will not provide farmers with a long-term support program on which to base investment and management decisions. I recognize that it is very difficult to devise a long-term dairy policy in light of technological advances with which the dairy sector has been confronted with now and in future years. But to the extent that farmers can engage in rational planning, they will be better managers.

So we would support any possibility of developing a longer range plan, and that is what we tried to do in New York State when we looked at what needs to happen in our State to enhance agriculture. That is why we took a look at the year 2000 in 1983, and now we have tried to develop policies that lead us there.

We think that there would be some advantages in a longer range policy that would not be modified from year to year and that it would be appropriate for the Senate committee to consider a program to make it less attractive for a processor to sell to the Commodity Credit Corporation the CCC.

I think the way to best summarize our feelings is in a paper that was developed by Dr. Andrew Novakovic who is a leading professor from Cornell University who took a year's sabbatical and went to Wisconsin and took a look at dairy policy in Wisconsin.

Dr. Novakovic says this:

> One aspect of the price support program that has proven most unfortunate in recent years is that for many cheddar cheese and butter/powder plants it seems that the CCC has become the preferred market outlet, not the buyer of last resort.

He goes on to point out that once you get contracts with the CCC that it is more difficult to withdraw your milk from those plants and use it for either consumption by the public in the United States and therefore generates more problems. When we set it up, it was designed to be a buyer of last resort and now it has become a buyer of preference, particularly we think in California.

FEDERAL MILK MARKET ORDERS

The milk market orders play a significant role in the marketing of milk in New York State. Nearly 80 percent of the State's dairy farmers sell their milk to handlers regulated by Federal order 2, which includes part of New York and New Jersey. Another 10 percent of the State's dairy farmers sell to handlers regulated by Federal order 1, which is New England. This number is increasing with continued production cutbacks in New England.

The process of amending and consolidating Federal milk market orders is cumbersome and very time consuming. At the very least, an amendment to a Federal order will take 18 months. Furthermore, USDA will often avoid addressing controversial concerns, even when strong support is indicated by a majority of cooperatives or dairy farmers in the area.

In New York, there has been general support within the dairy production sector for milk market orders as a means of classifying milk by use, pooling returns from the sale of milk among all producers, and computing minimum prices for each class of milk.

The recommendations of the Commission in this regard are appropriate, and we think should be supported.

THE SEARCH FOR AN ANSWER

I will now try to close by providing you with what we think are some possible answers.

In many parts of America today dairy farming is the major agricultural and commercial activity holding the rural fabric together. As more and more dairy farms go out of business, the whole idea of "critical mass" necessary to support related commerce is lost. We have farm machinery dealers that go out of business, feed and fertilizer suppliers, milk processing plants and a whole host of other businesses simply cannot operate with a diminished dairy or agricultural community.

Senator BOSCHWITZ. What page are you on?

Mr. BUTCHER. I am excerpting from it. It is on page 7, I believe. What the U.S. dairy industry needs is another dairy policy that will work for 25 years without requiring a major congressional overhaul every other year. Knowing our need is easy; knowing how to achieve a policy is the difficult part.

One possibility would be to consider the price support program as it was operated in the 1950's and 1960's and early 1970's. But many things have changed since then, which makes a return to the earlier policies impossible, and we think counterproductive.

Another possible solution often suggested is the farm quota system. European and Canadian quota systems have been examined and are well documented. It is clear that the problems associated with the farm quota systems are real and sufficient to have prevented their use in this country up to this time.

I think the two greatest drawbacks to supply management are these. One, that the incentive to remain competitive and as efficient as possible is lost. If you have a quota that is produced by 50 cows to become more efficient, to earn more money, there is no advantage for you because you are limited by the quota and your supply.

The other thing is the cost of getting into business for young people, and I think that is one of our serious problems that our dairy farming community is an aging population, and our young people are not coming along to continue in this very significant industry.

And we think that if you put in quotas that people have to purchase in addition to the purchase of the land and equipment—I was in Quebec yesterday, and they have a strong quota system and the Minister of Agriculture told me that a young farmer just got into business and it cost him $750,000 for a 50-cow farm in Quebec.

And that is because he had to buy the quota and had to buy the land and buy the equipment. So we think it keeps out young people, and we think that is not good.

[The prepared statement and attachments 1–4 of Mr. Butcher follow:]

Statement
to the
Senate Committee on Agriculture, Nutrition and Forestry

Commissioner Donald G. Butcher
New York State Department of Agriculture and Markets
May 11, 1988

Chairman Leahy and distinguished members of Congress, I appreciate this opportunity to appear before you today. I commend the Committee for the efforts being made to address the concerns of dairy farmers and to develop a sound long-term national dairy policy.

As the nation's third largest dairy state, New York is vitally concerned with the future of dairy policy. Dairying has a long history in New York. While the state was at one time predominately a fluid milk market, today there is a relative balance between the fluid and manufacturing sectors. Annual farm receipts for milk production in New York are approximately $1.5 billion, or nearly three-fifths of the total value of agricultural output in the State. The State's 13,000 dairy farmers have $6 billion invested in their operations. Our dairy farms are family farm operations and all indications are that they will continue to be family operations into the 21st century.

New York's output of dairy products is geared for commercial markets. This is logical in light of our close proximity to large urban markets.

New York dairy farmers as with farmers in other states, have had difficult economic problems in the 1980's. Thousands of dairy farms which operated in 1980 are now idle in 1988. A recent farm financial survey conducted by the Department indicated that over 21 percent of our dairy farmers have a debt to asset ratio in excess of 40 percent. Furthermore, 7 percent of our dairy farmers indicated that they will leave farming in 1988. Dairy farming in general has not been very profitable in this decade. A recent dairy farm rally held on April 25, 1988 at the State Capitol in Albany highlighted many of the economic difficulties confronting dairy farmers in the State. Furthermore with a 50 cent reduction on January 1 and the possibility of another 50 cent reduction next January, we have seen increased numbers of dairy farm auctions throughout the state.

The Dairy Termination Program had a significant impact on milk production in New York State. While most other major producing states quickly rebounded with increased production, New York milk production was slow in returning to previous levels. This has meant shortages in milk for a number of cheese companies which produce for commercial markets only. In fact, New York cheese companies with aggressive marketing programs have had to place on hold plans for expansion as a result of milk supply problems. I would note that in the marketing year 1986-87, New York's sales to the CCC were less than 1% of CCC purchases.

In 1987 the Milk Market Administrator for Federal Order 2 (New York-New Jersey) conducted two hearings (September and December) to consider invoking a "call" order to ensure an adequate supply of fluid milk for the market. The actual implementation of the call was avoided by voluntary efforts by Class 2 handlers to make available more milk for fluid use.

New York State dairy farmers and New York State government have undertaken several initiatives to improve our situation. Some of these warrant mention here today. Recently Governor Cuomo called for the development of a Net Dairy Farm Income Enhancement Program. As the first phase of this program, the Governor and legislative leaders have agreed to a $350,000 appropriation for a Dairy Profitability and Productivity Project. The project, being conducted through Cooperative Extension in conjunction with the Department of Agriculture and Markets, will focus on instructional programs to help dairy farmers improve management skills and, ultimately, profitability. This project should also help farmers to evaluate and adopt new farm technologies in future years. Through this special effort, we hope to reach dairy farmers not reached by existing extension programs.

Another positive initiative in the Northeast is our effort to bargain for over order prices through the Regional Cooperative Marketing Agency (RCMA). RCMA represents cooperatives and independent dairy farmers in negotiations with milk dealers. While over-order pricing has been established on Class 1 milk in many major markets areas throughout the country, this has not happened until recently in the Northeast. This is largely because of the fragmentation which has existed in our dairy production sector. My Department has been very supportive of this initiative. The effort has also brought together dairy cooperatives, general farm organizations including the Grange and Farm Bureau and independent dairy farmers. In light of reductions in the federal support price for milk, the RCMA over order program is essential to the future of the dairy industry in New York. Should this program fail as a result of the unwillingness of milk dealers to cooperate, I believe significantly more farmers will be forced out of dairying.

Another effort to make our industry competitive is the elimination of restrictive and burdensome milk dealer licensing regulations and statues. With Governor Cuomo's legislative initiative, we completely reformed the way in which milk dealers are licensed in New York State. A further effort is now underway in the Northeast to move toward uniformity in rules, regulations, laws and procedures relating to milk sales and distributions. We continue to be concerned with the lack of reciprocity in sanitary inspections by a few states, but we hope that our efforts through the Northeast Association of State Departments of Agriculture will eliminate restrictions which effect the movement of milk and dairy products between states.

Also under review in the Northeast is a proposal to establish a Northeast Interstate Dairy Compact. The focus of the effort has been with the State of Vermont and New York and particularly with legislative leaders of those two states. The main advantages of such a compact would be:

- to achieve complete uniformity of laws, regulations, policies, and procedures governing the production and marketing of milk in the Northeast; and
- to eliminate all duplication of licensing, producer security reports, audits and inspections.

Dairy Farm Protection Act

Recent proposals and discussions on national dairy policy and dairy price support programs are of utmost concern. I congratulate Senator Leahy for his efforts to focus on the regional implications of national dairy policy in his Dairy Farm Protection Act. This legislation has helped to stimulate discussion and debate over a proposed new direction in dairy policy.

There are differences in the dairy industry throughout the country. Different areas of the country produce different amounts of milk, different amounts of dairy products, face different farm prices for milk, and sell different amounts of dairy products to the Commodity Credit Corporation (CCC). In fact, the Federal Government already recognizes to a certain extent that regional differences exist in the dairy industry in the U.S. The USDA has administered Federal Milk Market Orders on a regional basis throughout the U.S. since the 1930's.

New York and other northeast states sell a relatively small portion of their milk marketing to the CCC. New York produced 8.2 percent of the nation's milk supply in 1986. The State's share of CCC purchases in 1986 (butterfat basis) was 1.9 percent. This compares to California with 12 percent of the Nation's production and 14.8 percent of CCC sales; Minnesota with 7.4 percent of national production and 22.9 percent of CCC purchases and the State of Washington with 2.6 percent of national production and 8.8 percent of CCC purchases. The present program which provides for support price reductions nationwide as as result of CCC purchases in certain areas of the country has serious regional implications, particularly for those areas of the country that have a relative balance between supply and demand.

We are concerned in the Northeast that the present policy will temporarily solve milk surplus problem by destroying the dairy industry in New York and other Northeastern states. What we have witnessed since the whole herd buy out program defies economic logic. We have a generally tight milk supply, increasing demand for milk, especially by our cheese makers and falling prices to farmers.

For the purposes of our review of a regional support program, we utilized 10 regions as identified in a Congressional Research Service Study (Becker, July, 1987). We have listed CCC purchases for those regions with production levels for 1985 and 1986.

Comparison of Milk Production by Region and Sales to CCC by Region for 1985

1985 Region	1985 Milk Production (million lbs)	Percent of Total National Milk Production (Percent)	1985-86 CCC Sales (million lbs. milk equiv.)	Percent of Total National CCC Sales (Percent)
Northeast	28,679	20.0	674.3	5.4
Lake States	41,108	28.7	4587.8	37.1
Corn Belt	16,934	11.8	1760.3	14.2
Appalachia	8,689	6.0	275.5	2.2
Southeast	4,469	3.1	4.2	>1.0
Delta	2,635	1.8	0	0
Southern Plains	5,151	3.5	466.5	3.7
Northern Plains	5,526	3.8	947.4	7.6
Mountain	7,836	5.4	335.3	2.7
Pacific	21,956	15.3	3288.2	26.6
U.S. Total (less Alaska and Hawaii)	143,147		12339.6	

Totals may not add due to rounding

Comparison of Milk Production by Region and Sales to CCC by Region for 1986

1986 Region	1986 Milk Production (million lbs)	Percent of Total National Milk Production (Percent)	1986-87 CCC Sales (million lbs. milk equiv.)	Percent of Total National CCC Sales (Percent)
Northeast	28,835	20.1	98.1	1.9
Lake States	40,518	28.2	1716.3	33.5
Corn Belt	16,941	11.8	329.1	6.4
Appalachia	8,769	6.1	79.5	1.5
Southeast	4,511	3.1	5.5	>1.0
Delta	2,483	1.7	3.3	>1.0
Southern Plains	5,279	3.6	218.3	4.2
Northern Plains	5,447	3.7	432.5	8.4
Mountain	7,937	5.5	130.0	2.5
Pacific	22,473	15.6	2105.6	41.1
U.S. Total (less Alaska and Hawaii)	143,381		5118.2	

Totals may not add due to rounding

I believe this data explains the concern of many dairy farmers in the Northeast who face lower prices as a result of purchases by the CCC in excess of 5 billion pounds (milk equivalent). I fully recognize that data on CCC purchases may not always tell the full story as to where the product was produced or if milk in one region was displaced by increases in production in another region. However, it is difficult to justify the fact that the Pacific region produced less than 16 percent of the milk supply and accounted for over 40 percent of CCC purchases. California and Washington State dairy interests have effectively utilized the support program to develop their dairy processing industry. This issue needs to be studied as future dairy policy is developed.

There is one aspect of the Dairy Farm Protection Act about which I want to express concern. This legislation proposes that the average of a region's CCC sales during the past two years serve as the region's base. States having little or no sales during the past two years would get little or no base. I believe that in developing the base for such a program, consideration should be given to the possibility of a longer base period of CCC sales and should also factor in the proportion of total milk production from the region. We feel strongly that this is necessary if American dairymen in all regions are to receive equity.

National Commission on Dairy Policy

There are a number of recommendations in the recently released report of the National Commission on Dairy Policy which I support. There are also parts of the report which need further review. Let me comment briefly on some of those provisions.

Milk Price Support Policy:

The establishment of a formula for setting the price support level for milk has been discussed for a number of years. This should be done if we are to continue a support program based on purchases. A formula would allow for appropriate adjustments to be made automatically to the support program without a decision from the Secretary of Agriculture and without congressional action. It would also allow for better planning by our dairymen.

The recommendation that total adjustments in the support price not exceed 50 cents per hundredweight annually should also be supported. This allows time for the dairy industry to adjust to lower support levels. Again, planning and adjustments are essential to good management and our dairy policy should permit both.

The recommendation to provide discretionary authority to the Secretary of Agriculture to make adjustments to the price indicated by the formula is less desirable. Discretionary authority granted to the Secretary of Agriculture often leads to political controversy when used in farm support programs. If the economic formula is properly developed, it should provide consideration of all appropriate factors, and discretionary authority should be unnecessary.

With regard to the Commission's recommendations for standby authority for supply control programs, I note that this seems to be inconsistent with the long term objectives of the Commission. The proposal as made will not provide farmers with a long-term support program on which to base investment and management decisions. The farmer will not know from year to year whether or not a supply management program will be established. I recognize that it is very difficult to devise a long-term dairy policy in light of technological advances with which the dairy sector will be confronted in future years. But to the extent that farmers can engage in rational planning they will be better managers.

I would recommend that with respect to the standby supply control program that consideration be given to a regional approach as suggested by the Dairy Farm Protection Act. If a two-tier pricing or whole herd buyout program is implemented, why not focus it where CCC purchases are the greatest? It is within the context of a standby production control program that I suggest a regional program be considered. This would help to reduce CCC purchases and government costs, but would not cause cutbacks in regions which are producing for commercial markets. I beleive that it would also be appropriate for the Senate Committee to consider a program to make it less attractive for a processor to sell to the Commodity Credit Corporation. A paper by Andrew Novakovic, Cornell University, addresses this idea:

"One aspect of the price support program that has proven most unfortunate in recent years is that for many cheddar cheese and butter/powder plants it seems the CCC has become the preferred market outlet, not the buyer of last resort." And, "Manufacturers, no matter what their sales outlets, prefer to run their plants as full as possible. Those who sell largely to the CCC want milk just as badly as any other processor. As easy as it is to sell to the CCC, it is often hard to pull milk out of plants that serve the CCC. Returns to such sales can be better that the returns to serving commercial markets." (Novakovic, Andrew; "Regional Differences in the Dairy Industry and Implications for Dairy Support Policy", November, 1987).

Federal Milk Market Orders

Milk market orders play a significant role in the marketing of milk in New York. Nearly 80 percent of the state's dairy farmers sell their milk to handlers regulated by Federal Order 2, which includes part of New York and New Jersey. Another 10 percent of the state's dairy farmers sell to handlers regulated by Federal Order 1 in New England. This number is increasing with production cutbacks in New England.

The process of amending and consolidating federal milk market orders is cumbersome and very time-consuming. At the very least, an amendment to a federal order will take 18 months. Furthermore, USDA will often avoid addressing controversial concerns, even when strong support is indicated by a majority of cooperatives or dairy farmers in the area.

In New York, there has been general support within the dairy production sector for milk market orders as a means of classifying milk by use, pooling returns from the sale of milk among all producers, and computing minimum prices for each class of milk.

The recommendations of the Commission in this regard are appropriate and should be supported. Of particular interest to New York farmers is a more expeditious process for consideration of amendments and a better procedure for consideration of consolidation of market orders. Such consolidation could, in some cases, lead to greater marketing efficiencies and possibly reduce administrative costs.

The Search for an Answer

What the U.S. Dairy Industry needs is another dairy policy that will work for 25 years without requiring a major Congressional overhaul every other year. Knowing our needs is easy; knowing how to achieve a policy is the difficult part.

One possibility is to consider the price support program as it was operated in the 50's and 60's and early 70's. But many things have changed since then, which makes a return to the earlier policies impossible. Technological advances on the production side have been rapid and are accelerating. And financial investment in commercial dairy farms has increased tremendously in the last decade alone.

Under the old price support program, the Secretary of Agriculture was given authority to adjust the support level up or down as seemed appropriate within a given range. Economic principles operated to insure that the least efficient dairy farmers were forced to exit dairy farming. As difficult as it was to leave farming then, it is more difficult today. A dairy farm in the 50's and 60's on average had a much smaller investment. It was easier to exit dairy farming without losing as much as dairy farmers stand to lose today. There were alternative agricultural enterprises that were not as expensive to enter or as technologically specialized as they are today. Even alternative non-agricultural employment was more available than in today's economy with demands for increased higher education and experience requirements.

In many parts of the America today dairy farming is the major agricultural and commercial activity holding the rural fabric together. As more and more dairy farms go out of business in an area, the "critical mass" necessary to support related commerce is lost. Farm machinery dealers, feed and fertilizer suppliers, milk processing plants and a host of other businesses simply cannot operate with a diminished farm community.

The price support policy of the 50's and 60's doesn't seem to meet the challenges of the 80's and beyond. Agriculture in the U.S. today--not just dairy farming--is facing very tough times. Better policies are required for the more difficult problems of the future.

A second possible solution often suggested is a farm quota system. European and Canadian quota systems have been examined and are well documented. It is clear that the problems associated with farm quota systems are real and sufficient to have prevented their use in this country up to this time. Probably the greatest drawback of a farm quota system is the potential for stagnation that may develop in such a system. The incentive to remain competitive and as efficient as possible is weakened under such a program. A quota program may discourage the adoption of new technologies to improve industry efficiency and could also make it more difficult for young people to become dairy farmers. Administration of quota systems is also difficult and, once started, quota systems are almost impossible to end.

If the old system is obsolete because of technology, and if the quota system creates more problems than it solves, then we should at least consider a regional plan. I have previously pointed out that present dairy policies result in significant differences between regions. While a processor in one part of the country may not get an adequate supply of milk to meet commercial needs, another processor may be selling their product to the Commodity Credit Corporation. I think a dairy program to discourage this type of activity should be sought.

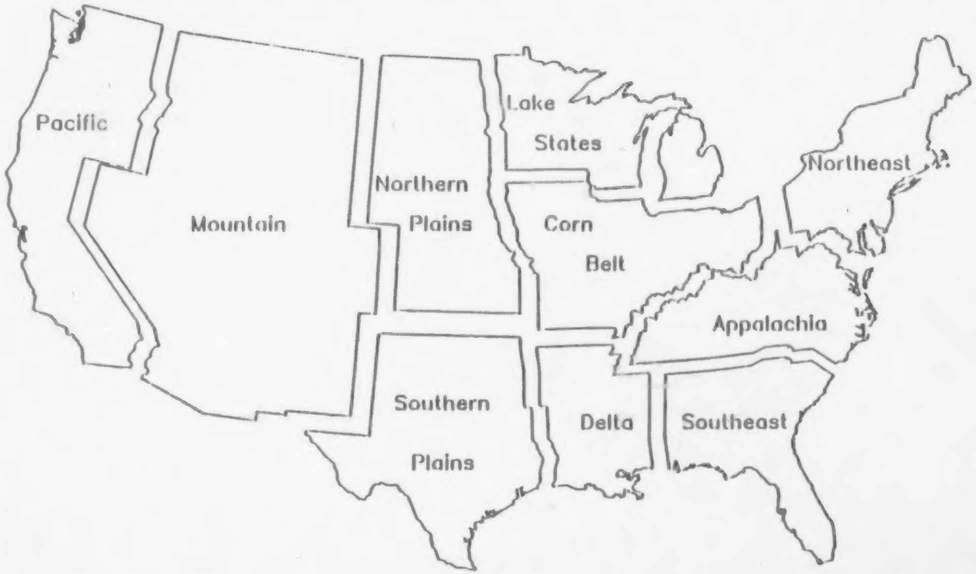
I would close by noting that while I have focused on national dairy policy, I believe that it is critical that we consider the larger picture. It is important that we view the whole rural economy in developing agricultural policy. I know that Chairman Leahy and other members have already taken steps to focus more on rural economic development initiatives. It is evident that new technological advances, particularly in the area of biotechnology, may mean fewer dairy farms in the future. We must be concerned with rural development which can provide employment opportunities for displaced farmers. Increased assistance will need to be given to dairy farmers to evaluate and adopt, as appropriate, new technologies in such areas as biotechnology, disease control, ultrafiltration, reverse osmosis and computer technology. I strongly support efforts in advanced applied research and development and the establishment of programs to foster agricultural alternatives and diversification. Of particular importance in New York has been the development of a New York State Agricultural Research and Development Program and a Farming Alternatives Project. Further concerns such as financial and legal counseling and health insurance for farmers under financial difficulties need to be constantly monitored.

Thank you for your consideration of my views.

Attachments 1-4 follow:

Attachment 1

Ten Dairy Production Regions Selected For Evaluation


Pacific
Mountain
Northern
Plains
Southern
Plains
Lake
States
Corn
Belt
Delta
Northeast
Appalachia
Southeast

Source: Geoffrey Becker, "Regional Dairy Trends and Federal Policy", CRS, July 1987, P. 4

Attachment 2

States Listed by Region for the Ten Region Model

REGION/STATE

1. NORTHEAST
    - Maine
    - New Hampshire
    - Vermont
    - New York
    - Connecticut
    - Pennsylvania
    - Massachusetts
    - Rhode Island
    - New Jersey
    - Maryland
    - Delaware
2. LAKE STATES
    - Michigan
    - Wisconsin
    - Minnesota
3. CORN BELT
    - Iowa
    - Ohio
    - Indiana
    - Illinois
    - Missouri
4. APPALACHIA
    - West Virginia
    - Virginia
    - Kentucky
    - North Carolina
    - Tennessee
5. SOUTHEAST
    - South Carolina
    - Georgia
    - Alabama
    - Florida

REGION/STATE

6. DELTA
    - Arkansas
    - Louisiana
    - Mississippi
7. SOUTHERN PLAINS
    - Texas
    - Oklahoma
8. NORTHERN PLAINS
    - North Dakota
    - South Dakota
    - Nebraska
    - Kansas
9. MOUNTAIN
    - Montana
    - Idaho
    - Wyoming
    - Colorado
    - New Mexico
    - Arizona
    - Utah
    - Nevada
10. PACIFIC
    - Washington
    - Oregon
    - California

Attachment 3

MILK PRODUCTION BY REGION, 1984,1985,1986,1987, AND ESTIMATED 1988.

REGION	1984 MILK PRODUCTION	1985 MILK PRODUCTION	1986 MILK PRODUCTION	1987 MILK PRODUCTION	ESTIMATED 1988 MILK PRODUCTION
			(MILLION POUNDS)		
1-NORTHEAST	27595	28679	28835	28139	28702
2-LAKE STATES	39182	41108	40518	40484	41660
3-CORN BELT	16080	16934	16941	16450	16779
4-APPALACHIA	8243	8689	8769	8465	8296
5-SOUTHEAST	4249	4469	4511	4413	4457
6-DELTA	2548	2635	2483	2411	2290
7-SOUTHERN PLAINS	4978	5151	5279	5470	5689
8-NORTHERN PLAINS	5172	5526	5447	5443	5579
9-MOUNTAIN	7137	7836	7937	7828	8063
10-PACIFIC	20105	21956	22473	23168	24320
US TOTAL *	135479	143147	143381	142462	146024

* TOTALS DO NOT ADD BECAUSE THEY INCLUDE ALASKA AND HAWAII.

Attachment 4

Sales to CCC by Region, Ten Regions, Marketing Years, 1984-85, 1985-86, 1986-87 and Estimated 1987-88. 1/

Region	1983-84 CCC Sales	1984-85 CCC Sales	1985-86 CCC Sales	1986-87 CCC Sales	Estimated 1987-88
	(Million Pounds Milk Equivalent)				
1-Northeast	782.1	456.7	674.3	98.1	140.3
2-Lake States	4,706.3	4,774.6	4,587.8	1,716.3	2,437.1
3-Cornbelt	925.8	1,348.6	1,760.3	329.1	487.1
4-Appalachia	133.4	148.7	275.5	79.5	115.3
5-Southeast	7.9	16.0	4.2	5.5	7.7
6-Delta	0	0	0	3.3	4.6
7-Southern Plains	317.9	370.1	466.5	218.3	316.5
8-Northern Plains	992.8	856.5	947.4	432.5	605.5
9-Mountain	343.0	304.5	335.3	130.0	195.0
10-Pacific	2,130.9	3,156.7	3,288.2	2,105.6	2,990.9
US TOTAL 2/	10,340.1	11,432.1	12,339.6	5,118.2	7,300.0

1/ CCC sales figures are obtained from "1986-87 Dairy Price Support Program", ASCS Commodity Fact Sheet, March, 1987. The gross purchases on a delivery basis of butter and cheese reported, by state, were converted to a milk equivalent basis and added together to obtain this data.

2/ Totals may not add due to rounding.

The CHAIRMAN. I would like to go back to what you said earlier. Are you saying that if we stick with the current national dairy policy, and assuming that the West and the South continue to grow, that would destroy the dairy industry in the Northeast?

Mr. BUTCHER. Yes, I suggest that with another cut next year probably we are going to lose another 8 percent of our dairy farmers in New York State, and the cut next year would continue this. We would be blacktopped from Montauk to Buffalo, and unless you want a big landing strip, that is not going to be really a very productive use of our land.

The CHAIRMAN. Is there anything that can be done in the Northeast by working together? Can they change that or does it have to be a national policy change?

Mr. BUTCHER. What we would like to see is really a national policy change that would encourage regionalization, consolidation of Federal orders into larger orders, regional orders. And that yes, we can work together, and we are working together, the commissioners of the Northeast and the Governors of the Northeast are working to try to take down the barriers between the States, trying to have consistent health regulations, and encourage trade between the States.

The CHAIRMAN. If you were working on the dairy section of the 1990 farm bill, how would you write it?

Mr. BUTCHER. I would write it so that you would encourage regionalization, in that I would try to look at a system that if you are really, and I agree that we need to reduce Federal purchases, or purchases by the CCC. I think that has to be done more on a regional basis. That to continue to cut across the board to me reminds me of a coach that comes in at the halftime and gives his speech to 50 players, and he chews out all 50 players, and 4 have made the mistakes in the first half. And it seems like instead of focusing and taking the 4 aside and talking with the 4 and dealing with the 4 people that created a problem, the interceptions or something, you are beating on all 50 people.

It seems to me that this analogy compares when you have four States essentially contributing that provide 40 percent of the production nationally and sell 65 or 64 percent of the purchases to the CCC, that the only way you can reduce production is not across the board. Keep reducing the size of the Northeast dairy herds in my opinion only leads to elimination of that industry and then you rely either on, as you suggested, either on other countries, opening up those borders, or two or three States to produce all of the fluid milk and dairy products in the country.

So it seems to me that you have to have a Federal dairy policy that accommodates a regional approach, but also you have to figure out a way to have a two-tier system if you have a whole herd buyout which was suggested by the National Commission on Dairy Policy or a pricing plan. The pricing plan has to be applied differently, in my opinion, to those regions where they have continued to grow as has been suggested, Texas, California, and Washington State.

They are not producing for the fluid market. They are producing for the manufactured markets in their State at the expense, in my opinion, of the other parts of the country.

The CHAIRMAN. My 5 minutes is up. Senator Lugar.

Senator LUGAR. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. No, that's fine.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. I notice you say that your State's share of CCC purchases is very low, and you make the comment later on, "I fully recognize the data on CCC purchases may not always tell the full story as to where the product was produced."

How much of your milk during the flush season do you send out to other regions where it might be manufactured and eventually surrendered to the Government?

Mr. BUTCHER. I don't believe any. Bob.

Mr. SMITH. It would be very little, sir. In recent years, hardly any at all.

Mr. BUTCHER. We have a large manufacturing industry in New York State, the cheese manufacturers. We have Kraft and Poly-O, Sorretto, Leprino. So that we do not ship the fluid milk. We would not be shipping the fluid milk. But it is accommodated by the manufacturing process. They have a difficult time keeping going during the months of September through February.

Senator BOSCHWITZ. Well, up our way our experience has been that we receive a considerable amount of milk from around the country. Some Members have told me that their producers do not surrender a single pound of milk to the Federal Government. That is because they ship it to us. Milk kind of moves back across the country toward the manufacturing areas.

What would Professor Samuelson, your mentor, say to you about this system of marketing orders and regionalization? You quoted him as your teacher of economics. Do you think he would have approved of the idea of regionalization and these artificial types of barriers? On the one hand, you do not like quotas for farmers, but you want quotas for regions. Very interesting approach. What would he say about milk marketing orders and their impact of stopping a more natural economic flow?

Mr. BUTCHER. I think that you have to accept where you are, and for 50 years, we have had a system that we have conditioned our dairy farmers to behave a certain way. I think that in the long haul we should eliminate all barriers, but I think it has to be phased, and it has to be in a long-range plan that would lead us to a total free market system. I would support that, of course, and so would he, of course.

But I think that to suggest that it can be done over a short period of time, or that it is not done over a phased period of time, if you really——

Senator BOSCHWITZ. Do you feel that regionalization is a step toward a free market system?

Mr. BUTCHER. I think so, yes. I think yesterday——

Senator BOSCHWITZ. How in the world can you support that?

Mr. BUTCHER [continuing]. Let me try to respond to that. Yesterday we heard a distinguished professor from Berkeley, California talk to us about what is happening in the food distribution system. He suggests that we are not having national chains anymore. That our food distribution system is a regional food distribution system.

That we have gone from national back to regional because of the consumer demands, rapid changing of consumer interests, and so that we are going more to regional distribution of food system.

As you look at that, that looks like where we are going, and a regional plan for distribution of fluid milk is important.

Senator BOSCHWITZ. What possible bearing does distribution of food, of other types of food, have upon the issue at hand? I do not quite follow that. I must tell you that I do not think, Mr. Butcher, that you do the whole business of trying to solve the dairy problem much good by coming in and starting to point fingers at various regions. Yes, you point fingers at our region even though our region is a larger producer, and in relationship to what is surrendered to the Government, is not as high as California.

And yes, I think that California has some particular aspects of its own plan that perhaps make it more advantageous to produce milk. We have to examine the differences and make provisions and so forth as we go along.

What about consumption? What have you done? You only talked about production here. What is your thoughts about consumption of dairy, and do you think that some of the problems with respect to oversupply might be solved through raising consumption?

Mr. BUTCHER. Yes, I do think that you can solve some of the problem by increasing consumption. We have tried to use the promotional moneys in our State to promote increased consumption of fluid milk in New York City. Changing the consumption in New York City a point or two, a percentage or two, makes quite a bit of difference in fluid milk. So we think we have been working at that. We have been trying to expand the consumption of fluid milk. I do not really mean, Senator, to point the finger at anyone.

We tried to report the information as it is factually, and it is not intended to single out any particular region of the country. But I think that the figures support that.

Senator BOSCHWITZ. Well, if I may continue for a moment, Mr. Chairman. Apparently you did not read your own testimony very carefully if you did not think you pointed fingers, and you certainly did.

Recently I met with some dairy processors, and one of them is from New Jersey—Farmland Industries I think.

Mr. BUTCHER. Farmland Dairy.

Senator BOSCHWITZ. Farmland Dairy.

Mr. BUTCHER. Yes, sir.

Senator BOSCHWITZ. They are very anxious to impose an assessment on processors for the purpose of advertising fluid milk. Have you examined that in any way?

Mr. BUTCHER. Yes. In fact, I met with Mr. Goldman, the owner of Farmland Dairies, to talk about that. I think that idea has some merit. I do not believe it is possible under the present order system to do that.

But I am sure if we want to do it, I think that is the kind of thing that a regional compact could do in taking a look at ways that you could promote through some form of surcharge for handlers in addition to the other charges.

Senator BOSCHWITZ. Did you also talk about blacktopping from Montauk to Buffalo?

Mr. BUTCHER. Yes, sir.

Senator BOSCHWITZ. In the year 1959, there were about 2 million dairymen in the United States. Now, there are less than 300,000.

Mr. BUTCHER. I know that.

Senator BOSCHWITZ. Others have made those comments all along, I suppose, about the blacktopping from the Montauk to Buffalo. I think New York, as a practical matter, is going to have a very vibrant dairy industry. You have so many consumers. We look with some jealously upon the number of consumers that you have and that you are in the midst of.

We would hope that there would be a broader and more national solution, and that regional barriers would not now be erected, and do not think that regionalism would have a very advantageous impact on dairy as a whole. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Daschle.

Senator DASCHLE. No questions.

Senator MCCONNELL. I will pass, too, Mr. Chairman, so we can move along.

The CHAIRMAN. Thank you very much, Commissioner Butcher, for coming down today. As you can see, there may be some disagreements around the committee table on the direction to go, but I think all of us share the concern that we are reaching a point where we can determine whether we will have viable diversified dairy or concentrated dairy supplemented by foreign imports. I know which way I want to go. Thank you very much.

Mr. BUTCHER. Thank you.

The CHAIRMAN. Because we must be finished by noon, I will try to keep all Senators and the chairman to the 5-minute rule as well as witnesses. So I will ask our staff to run the stoplights here.

Our next witness is Brian Crowley, Senior Associate Director, Resources, Community, and Economic Development Division, General Accounting Office. He will be accompanied by Dale Wolden, from the General Accounting Office in Chicago and Ron Knutson, from Texas A&M University.

Mr. Crowley, we welcome you here, and your prepared testimony, of course, will be a part of the record. Please feel free to summarize in any way you would like.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DALE WOLDEN, GENERAL ACCOUNTING OFFICE, CHICAGO, IL; AND RONALD KNUTSON, CONSULTANT, PROFESSOR AND EXTENSION ECONOMIST, TEXAS A&M UNIVERSITY

Mr. CROWLEY. Thank you, Mr. Chairman. I want to correct the record with regard to Dr. Ronald Knutson. He is a consultant that we used on this particular job. He is a professor and extension economist at Texas A&M University. He was formerly administrator of the Farmer Co-op Service and chairman of the 1972 USDA Milk Pricing Advisory Committee.

Dr. Knutson has extensive experience with dairy marketing and policy matters and has assisted us on a number of jobs throughout the various years that we have been working on dairy programs.

The report I am going to be talking to you about this morning was also circulated to a number of other individuals besides Dr. Knutson. It was circulated to Dr. Bruce Gardner of the University of Maryland, Dr. Harold Harris, Jr., of Clemson University and Dr. Robert Cropp of the University of Wisconsin-Platteville.

Mr. Chairman, you did to me this morning what I was afraid you were going to do which was to request me to summarize my statement in 5 minutes. Normally I come up here with an ability to do that. Quite frankly, I went through the nine pages several times, and I had a great deal of difficulty summarizing it because it lays out, I think, in pretty good fashion our rationale and logic. I will try to cut it down, but please bear with me this morning.

The summary of my statement is, that basically, we believe that the Federal milk marketing order system should be changed because its pricing provisions have contributed to excess production of milk and because it treats some producers unfavorably compared with others. You have heard that on a number of occasions already this morning.

Further, the premises for milk pricing——

Senator BOSCHWITZ. Mr. Chairman, if I may interrupt, may I ask that the witness need not abbreviate his remarks. Certainly, from my standpoint, this is a very significant report that GAO has made, and it is not a very long statement they are making.

The CHAIRMAN. Well, just understand that I would hope we would have a chance to hear all witnesses, but if there are any left at 12 o'clock we will put their statements in the record.

Senator BOSCHWITZ. Fine.

The CHAIRMAN. I will be willing to waive some of Senator Boschwitz' time so you will have more time. Go ahead.

Mr. CROWLEY. I will cut out some paragraphs, sir.

Further, the premises for milk pricing under Federal orders are outdated. We no longer need to encourage and maintain a locally produced supply of milk adequate to meet all local demands at all times. Milk is produced in all regions of the country, and technologies are available to transfer it, either in fluid form, or in a form later to be reconstituted as fluid, should local shortages develop. Further, recent increases in dairy productivity and emerging technologies have the potential to greatly increase milk output per cow while reducing production costs. These advances will further increase dairy surpluses.

We concluded that two basic strategies for changing Federal milk marketing orders could be pursued. One strategy involves establishing programs that control production, and the other involves program changes that would lessen Government influence on milk prices to permit market forces to play a greater role.

Before we get into these strategies, let me discuss order pricing policies, and their effects on both national and regional production patterns, as well as their impact on Government purchases.

ORDER PRICING POLICIES

First, I would like to address milk marketing order pricing policies.

Fluid milk prices under Federal orders have two components in addition to the Minnesota-Wisconsin price which applies to milk used for manufacturing. One, a Grade A differential is $1.04 per hundredweight incentive to encourage farmers to upgrade their facilities to meet higher Grade A sanitary standards. The other component, a distance differential, increases the guaranteed price for milk used for fluid consumption, and is generally based on the distance a plant is from the Eau Claire, Wisconsin, basing point.

These pricing policies are not based on current dairy market conditions. First, the Grade A differential is far higher than the added cost of producing Grade A milk instead of Grade B milk. The added cost may be no more than 15 cents per hundredweight compared with the existing differential of $1.04. Further, about 88 percent of all milk produced in this country is Grade A, far more than is needed for fluid milk markets. Fluid consumption is about 36 percent of production.

Distance differentials were set up to make it profitable to transport milk from surplus to deficit areas. Although designed to provide incentives for Upper Midwest producers to transport milk to other regions, distance differentials increased the incentive to produce milk in areas distant from the Eau Claire basing point. This led to surpluses in many regions, at the expense of producers in other regions, with the additional price incentive bearing no relationship either to the cost of production or to the cost of obtaining an alternative source of supply.

Other factors to consider are the down allocations and compensatory payments which are other marketing order provisions designed to economically discourage the shipment of surplus milk from one market area to another, unless there is a deficit. They effectively prohibit the use of reconstituted milk, which is a more efficient means for moving milk between distant locations. These provisions foster local production of milk by protecting local producers from the competitive advantages of reconstituted milk.

EFFECT ON PRODUCTION PATTERNS

Next, I would like to discuss the effect of milk marketing orders on national production. National milk production increased 15 percent between 1977–79 period and the 1984–86 period. While we recognize that price supports have played a major role in increased production, we believe that the economic incentives provided by the milk marketing orders, primarily through the Grade A and distance differentials, contributed to this increase in production. At any given support price, Federal orders add a price differential that encourages additional milk production. However, as a result of the supply-demand adjuster provisions in the Food Security Act of 1985, any increases in production that could result in annual Federal purchases of surplus production in excess of 5 billion pounds now trigger a downward support price adjustment.

EFFECT OF MARKETING ORDERS ON REGIONAL PRODUCTION PATTERNS

This brings me to the effect of marketing orders on regional production patterns. Distance differentials provide production incentives in all regions of the country, except the Upper Midwest.

These differentials were increased by the Food Security Act of 1985. The greater these differentials, the greater the production incentives, and therefore, the more likely that surpluses will rise enough to cause the support price to fall. A combination of higher differentials and lower support prices can have a particularly adverse impact upon traditional milk-producing regions of the Upper Midwest, which receive little or no benefit from the differentials, but which would be hurt by declines in the support price.

Traditionally, the Upper Midwest and the Northeast have been the major milk-producing areas. Since the late 1960's, there has been a significant trend toward increased production in all areas of the United States, but predominantly in the Northwest, Southwest, and Southern Plains. Data are not available to determine whether this increased production is solely attributable to the pricing policies of milk marketing orders; however, the correlation between profitability and increases in production is relatively consistent.

The regions with the greatest rate of increase in milk production between the 1977–79 period and the 1984–86 period were the Northwest, with a 38-percent increase, the Southwest, with a 35-percent increase, and the Southern Plains with a 25-percent increase. These regions also experienced the highest average profit between 1977 and 1986, and also have higher differentials because of their distance from the Upper Midwest. The Corn Belt and the Southeast had only minor increases in production. However, the Southeast, with the highest differentials, has increased production even though it has a relatively high cost of production.

GOVERNMENT PURCHASES OF SURPLUS MILK

While Government purchases of surplus production under the price support program have also been occurring in all regions of the United States, the rate of increase in some regions has been greater than in others. The Northwest, the Southern Plains, and the Western Plains have the greatest rate of change. The correlation pattern between profitability, influenced by the higher distance differentials, and rate of change in milk production also carries over to the rate of change in Government purchases. For example, the Northwest, the Southern Plains, and the Southwest, with an average profit from 1977 to 1986 of $2.96, $2.59, and $2.96 per hundredweight, respectively, show increases in sales to the Government of 695 percent, 4,227 percent, and 262 percent, respectively.

Normally, increases in Government purchases would be expected to occur in regions with high production and low fluid use patterns, such as the Upper Midwest. However, because guaranteed prices under milk marketing orders provide increased incentives to produce milk as the distance increases from the Upper Midwest, all areas have increased production, so that the Government has purchased surplus manufactured dairy products from all regions. This relationship is especially evident from the increase in the rate of change in the purchases in those regions having high milk prices relative to the cost of production, such as the Northwest, the Southwest, and the Southern Plains.

Recent technological advances in dairy production threaten to further aggravate the milk surplus situation. According to a 1986 study by the Office of Technology Assessment, milk production per cow could double by the year 2000. Further, adoption of technology such as artificial insemination, embryo transfer, and bovine growth hormone promises increased herd productivity.

OPTIONS FOR CHANGE

Because of our findings, we analyzed various options for changing Federal milk marketing orders. We looked at a total of 12 including options to eliminate the Grade A differential; eliminate distance differentials; establish more basing points; eliminate down allocations and compensatory payments; establish transportation pools; establish marketing quotas; eliminate—excuse me.

The CHAIRMAN. That is OK. I have read it. Let me interject a moment.

Senator Boschwitz, even though this appears more and more to be a report written by Midwesterners for Midwesterners under the idea that God is ordained that milk be produced only in Minnesota, we have let the time keep on running and I am waiving my own time so it will be possible to——

Senator CONRAD. I am willing to waive my time, also.

The CHAIRMAN [continuing]. So that we can read into the record the report that you and I read last night. Go ahead, sir.

Senator BOSCHWITZ. That is a very decent approach, Mr. Chairman.

Mr. CROWLEY. OK. A couple of others were to establish marketing quotas; eliminate order pricing provisions, but retain order supervision; and eliminate orders entirely.

We then evaluated how the adoption of each of these options would affect various Federal dairy program goals. These goals relate to producer receipts, the orderliness of milk marketing, the level of national market production, the local supply of milk, and consumer prices.

Our analysis showed, for example, that eliminating distance differentials would most likely reduce national production in the short run. Because this change would almost certainly lower the price that producers receive, producers could be expected to reduce production. This option would also reduce the incentive to rely on local supply. The greatest reduction of milk production would occur in markets that are distant from Eau Claire.

After our analysis, we concluded that two basic strategies are available for changing the Federal milk marketing order system: adopting production controls or lessening Government influence on milk prices.

If production controls were chosen, some industry sources have suggested the option of a marketing quota system. Such a system would limit the quantity of milk that could be marketed at a given price by each producer as well as in total. Quotas could reduce national production, but have numerous drawbacks. Accordingly, we do not prefer a production control strategy.

We prefer the second strategy of lessening Government influence on milk prices so that market forces can play a greater role. Overall, with about 88 percent of milk production classified as Grade A, improved transportation, and new technology on the horizon, extensive Government regulation of fluid milk markets is needed less than in the past. A number of possible options for decreasing Government influence are available. These options include establishing more basing points and eliminating the Grade A differential, distance differentials, and down allocations and compensatory payments. Other options include eliminating order pricing provisions while retaining order supervisions, and eliminating orders themselves.

The CHAIRMAN. Are you saying that removal of the distance differential would lower prices paid by consumers?

Mr. CROWLEY. Prices paid by consumers are going to be related to several factors—in the long run it should.

The CHAIRMAN. But yet you take the retail price of milk—let me just take a place at random, Minneapolis—there is a higher price paid for milk there than in Bangor, Maine. But in Bangor the Maine producers can sell into markets with a $3.24 a hundredweight distance premium. Are they ripping them off in Minneapolis?

Senator BOSCHWITZ. That is right. They are.

The CHAIRMAN. It does not really jive with what you are saying. Here is an example of distance premium that is $3.24 a hundredweight in Bangor, and yet in Minneapolis we do not have that, and the consumer is paying more.

Mr. CROWLEY. If you look at what consumers pay, there is some relationship between what consumers have paid and what producers receive. Usually producers claim that if they get less of a price, that never shows up in the marketplace, that somewhere in the processing end of it, the middleman picks up the difference.

If there are differences like that, probably they should be looked at. But if you are looking at what the producer is paid and what the retail price of a commodity is, you can pretty much know that they will track each other.

If you are going to raise the price of what a producer receives, normally that is going to translate into an increased price at the retail level.

The CHAIRMAN. Here is an example where it did not.

Mr. CROWLEY. Well, it is an example I cannot really respond to because we did not study that particular aspect.

Senator BOSCHWITZ. Let me respond to it. Unfortunately, there are other Government restrictions with respect to milk marketing that are added on top of the Federal milk market orders, and those are some State restrictions in Minnesota that I would also like to do away with that do not allow a properly competitive environment.

The same thing happened in New York where they tried so long to keep those folks from New Jersey and others out of their area, and that is something else we should address at some point. But you are quite right, and I have not seen those figures.

The CHAIRMAN. I am wondering, is the fundamental criticism of these marketing orders not that they attract too much milk production, but they attract too much milk production in the wrong places?

We had the 1985 act. Did that set the differential too high in some regions like the Southern Plains? Your report notes the stage is being set—I quote—"the stage is being set for surplus production" in the Southern Plains.

Did we set the differential too high there, or was it too low in the Northeast where a lot of our plants are having a problem getting adequate supply? I wonder, because this is one of the questions we are obviously going to have to address in the 1990 farm bill. And while I can view the elections this year with a calm dispassionate nature of a political scientist because I am not running, I know that I am going to be a member of a committee having to determine what we are going to do in that farm bill next year. So I ask the question not just from an academic point of view.

Mr. KNUTSON. I think the action to increase distance differentials at the same time we were reducing the price support was incomprehensible to me why you would do that. And then I think regionally there were a lot of problems with how much the distance differentials were increased.

The CHAIRMAN. To make sure we do not have anymore whole herd buyouts?

Mr. KNUTSON. Well, of course, we did not evaluate the whole herd buyout in this particular study.

The CHAIRMAN. Rudy.

Senator BOSCHWITZ. Are you finished with your testimony?

Mr. CROWLEY. I had my wrap-up which is essentially to say—and I will go back to it—that all of the options would reduce the influence of marketing orders on regional production patterns and would have varying effects on consumer prices and market orderliness. National production would also fall, but such decline may be offset if the supply-demand adjuster causes the support price to rise. Although any or all of these options that we have discussed in the report could be adopted, the steps should be made incrementally, and I think you have heard that this morning already, to allow time for the dairy industry to adjust and for the Government to monitor such adjustments to ensure that unanticipated adverse effects do not occur.

The sequence of steps to change the system might be to take any one of those options, implement it, see how it worked, assess whether there is any problem with the change, or the impact of it, and then move to other options. We have spelled out a series of options. [See p. 199 of the prepared statement.]

With these changes, the price support level, as set by the adjuster provision in the Food Security Act of 1985 and competitive market forces, would play a larger role in setting the prices paid to producers, and that is really what we are shooting for in this report. Elimination of the pricing provisions would also lessen the likelihood that the support price supply-demand adjuster would trigger price reductions in the future. The above steps would eliminate the pricing aspects of the orders, but supervision would still exist. If appropriate, the next step could be to eliminate orders completely, but that would be further on down the line.

We believe that the best way to accomplish changes in the milk marketing order program is through the Congress. Therefore, we suggest that the Congress consider establishing the goal of decreasing the Federal role in milk pricing, and working with USDA to develop and adopt legislation necessary to accomplish that goal.

Mr. Chairman, that concludes my statement. We will be glad to answer your questions.

[The prepared statement of Mr. Crowley follows:]

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Options for Changing Milk Marketing Orders

Statement of
Brian P. Crowley, Senior Associate Director
Resources, Community, and Economic
Development Division

Before the
Senate Committee on Agriculture, Nutrition,
and Forestry
United States Senate

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U.S. General Accounting Office

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our recently issued report entitled Milk Marketing Orders: Options For Change (GAO/RCED-88-9). This is one of a series of reports that we have issued on federal dairy programs in recent years in response to continuing congressional interest and a desire to solve the dairy surplus problem.

As you know, since the federal government became involved in the dairy industry over 50 years ago, a major objective of its dairy policies has been to ensure an adequate supply of milk. Two programs, milk marketing orders and price supports, which were established to carry out federal policies, have been so successful that the dairy industry has consistently produced considerably more milk and other dairy products than consumers will buy at prevailing prices.

Marketing orders regulate the marketing of milk in those areas of the country where producers have voluntarily adopted them. Orders, which are supervised by the U.S. Department of Agriculture (USDA), set forth marketing practices, terms and conditions of sale; minimum prices that must be paid by handlers; and distribution of returns among producers. Orders apply only to grade A milk, which is produced to specific sanitary standards and is eligible for fluid consumption, regardless of end use. The majority of milk produced in this country is used for manufactured dairy products, even though most milk produced is grade A.

In summary we believe that the federal milk marketing order system should be changed because its pricing provisions have contributed to excess production of milk and because it treats some producers unfavorably compared with others.

Further, the premises for milk pricing under federal orders are outdated. We no longer need to encourage and maintain a locally produced supply of milk adequate to meet all local demands at all times. Milk is produced in all regions of the country and technologies are available to transfer it, either in fluid form or in a form later to be reconstituted as fluid, should local shortages develop. Further, recent increases in dairy productivity and emerging technologies have the potential to greatly increase milk output per cow while reducing production costs. These advances will further increase dairy surpluses.

We concluded that two basic strategies for changing federal milk marketing orders could be pursued. One strategy involves establishing programs that control production, and the other involves program changes that would lessen government influence on milk prices to permit market forces to play a greater role.

Before we get into these strategies, let me discuss order pricing policies, and their effects on both national and regional production patterns, as well as their impact on government purchases.

ORDER PRICING POLICIES

First I would like to address milk marketing order pricing policies. A uniform pricing system exists under milk marketing orders, based on competitive prices paid for milk by selected manufacturing plants in Minnesota and Wisconsin. These prices are the basis for all prices paid to farmers delivering milk to plants regulated by federal orders east of the Rocky Mountains. Milk marketed west of the Rockies is influenced by prices in California, which has its own milk pricing regulations and is not covered by federal orders.

Fluid milk prices under federal orders have two components in addition to the Minnesota-Wisconsin price which applies to milk used for manufacturing. One, a grade A differential, is a \$1.04 per hundredweight (cwt) incentive to encourage farmers to upgrade their facilities to meet higher grade A sanitary standards. The other component, a distance differential, increases the guaranteed price for milk used for fluid consumption and is generally based on the distance a plant is from the Eau Claire, Wisconsin, basing point.

These pricing policies are not based on current dairy market conditions. First, the grade A differential is far higher than the added cost of producing grade A milk instead of grade B milk. The added cost may be no more than 15 cents per cwt, compared with the existing differential of \$1.04. Further, about 88 percent of all milk produced in this country is grade A, far more than is needed for fluid milk markets.

Distance differentials were set up to make it profitable to transport milk from surplus to deficit areas. Although designed to provide incentives for Upper Midwest producers to transport milk to other regions, distance differentials increased the incentive to produce milk in areas distant from the Eau Claire basing point. This led to surpluses in many regions, at the expense of producers in other regions, with the additional price incentive bearing no relationship either to the cost of production or to the cost of obtaining an alternative source of supply.

Down allocations and compensatory payments are other marketing order provisions that are designed to economically discourage the shipment of surplus milk from one market area to another, unless there is a deficit. They effectively prohibit the use of reconstituted milk, which is a more efficient means for moving milk between distant locations. These provisions foster local production of milk by protecting local producers from the competitive advantages of reconstituted milk.

EFFECT ON PRODUCTION PATTERNS

Next, I would like to discuss the effect of milk marketing orders on national production. National milk production increased 15 percent between the 1977-79 period and the 1984-86 period. While we recognize that price supports have played a major role in increased production, we believe that the economic incentives provided by the milk marketing orders, primarily through the grade A and distance differentials, contributed to this increase in production. At any given support price, federal orders add a price differential that encourages additional milk production. However, as a result of the supply-demand adjuster provisions in the Food Security Act of 1985, any increases in production that could result in annual federal purchases of surplus production in excess of 5 billion pounds now trigger a downward support price adjustment.

This brings me to the effect of marketing orders on regional production patterns. Distance differentials provide production incentives in all regions of the country, except the Upper Midwest. These differentials were increased by the Food Security Act of 1985. The greater these differentials, the greater the production incentives and therefore the more likely that surpluses will rise high enough to cause the support price to fall. A combination of higher differentials and lower support prices can have a particularly adverse impact upon traditional milk-producing regions of the Upper Midwest, which receive little or no benefit from the differentials, but which would be hurt by declines in the support price.

Traditionally, the Upper Midwest and the Northeast have been the major milk-producing areas. Since the late 1960s, there has been a significant trend toward increased production in all areas of the United States but predominantly in the Northwest, Southwest, and Southern Plains. Data are not available to determine whether this increased production is solely attributable to the pricing policies of milk marketing orders; however, the correlation between profitability and increases in production is relatively consistent.

The regions with the greatest rate of increase in milk production between the 1977-79 period and the 1984-86 period were the Northwest, with a 38-percent increase, the Southwest, with a 35-percent increase, and the Southern Plains, with a 25-percent increase. These regions also experienced the highest average profit between 1977 and 1986 and also have higher differentials because of their distance from the Upper Midwest. The Corn Belt and the Southeast had only minor increases in production. However, the Southeast, with the highest differentials, has increased production even though it has a relatively high cost of production.

GOVERNMENT PURCHASES OF SURPLUS MILK

While government purchases of surplus production under the price support program have also been occurring in all regions of the United States, the rate of increase in some regions has been greater than in others. The Northwest, the Southern Plains, and the Western Plains had the greatest rate of change. The correlation pattern between profitability, influenced by the higher distance differentials, and rate of change in milk production also carries over to the rate of change in government purchases. For example, the Northwest, the Southern Plains and the Southwest, with an average profit from 1977 to 1986 of $2.96, $2.59 And $2.96 per cwt, respectively, show increases in sales to the government of 695 percent, 4,227 percent and 262 percent, respectively.

Normally, increases in government purchases would be expected to occur in regions with high production and low fluid use patterns, such as the Upper Midwest. However, because guaranteed prices under milk marketing orders provide increased incentives to produce milk as the distance increases from the Upper Midwest, all areas have increased production, so that the government has purchased surplus manufactured dairy products from all regions. This relationship is especially evident from the increase in the rate of change in the purchases in those regions having high milk prices relative to the cost of production, such as the Northwest, the Southwest and the Southern Plains.

Recent technological advances in dairy production threaten to further aggravate the milk surplus situation. According to a 1986 office of technology assessment report, milk production per cow could double by the year 2000. Further adoption of technology such as artificial insemination, embryo transfer, and bovine growth hormone promises increased herd productivity.

OPTIONS FOR CHANGE

Because of our findings, we analyzed various options for changing federal milk marketing orders. These options were suggested by various industry representatives or were discussed in literature we reviewed for our study. The specific options we analyzed were to

- eliminate the grade A differential;
- eliminate distance differentials;
- establish more basing points;
- eliminate down allocations and compensatory payments;
- establish transportation pools;
- establish a standby pool;
- establish marketwide service payments;
- establish regional orders;
- establish a national order;
- establish marketing quotas;
- eliminate order pricing provisions, but retain order supervision; and
- eliminate orders entirely.

We then evaluated how the adoption of each of these options would affect various federal dairy program goals. These goals relate to producer receipts, the orderliness of milk marketing, the level of national milk production, the local supply of milk, and consumer prices.

Our analysis showed, for example, that eliminating distance differentials would most likely reduce national production in the short run. Because this change would almost certainly lower the price that producers receive, producers could be expected to reduce production. This option would also reduce the incentive to rely on local supply. The greatest reduction of milk production would occur in markets that are distant from Eau Claire.

After our analysis we concluded that two basic strategies are available for changing the federal milk marketing order system*adopting production controls or lessening government influence on milk prices.

If production controls were chosen, some industry sources have suggested the option of a marketing quota system. Such a system would limit the quantity of milk that could be marketed at a given price by each producer as well as in total. Quotas could reduce national production, but have numerous drawbacks. Accordingly, we do not prefer a production control strategy.

We prefer the second strategy of lessening government influence on milk prices so that market forces can play a greater role. Overall, with about 88 percent of milk production classified as grade A, improved transportation, and new technology on the horizon, extensive government regulation of fluid milk markets is needed less than in the past. A number of possible options for decreasing government influence are available. These options include establishing more basing points and eliminating the grade A differential, distance differentials, and down allocations and compensatory payments. Other options include eliminating order pricing provisions while retaining order supervision, and eliminating orders themselves.

All of these options would reduce the influence of marketing orders on regional production patterns and would have varying effects on consumer prices and market orderliness. National production would also fall, but such decline may be offset if the supply-demand adjuster causes the support price to rise. Although any or all of these options could be adopted, the steps should be made incrementally to allow time for the dairy industry to adjust and for the government to monitor such adjustments to ensure that unanticipated adverse effects do not occur.

The sequence of steps to change the system might be

- first establish new basing points in various regions of the United States to minimize the influence on regional production patterns;
- then assess the impact of that change;
- next, remove down allocation and compensatory payment provisions to make reconstituted milk competitive;
- again assess the impact; and finally
- eliminate the grade A and distance differentials in federal orders.

With these changes, the price support level, as set by the adjuster provision in the Food Security Act of 1985 and competitive market forces, would play a larger role in setting prices paid to producers. Elimination of the pricing provisions would also lessen the likelihood that the support price supply-demand adjuster would trigger price reductions in the future. The above steps would eliminate the pricing aspects of orders, but supervision would still exist. If appropriate, the next step could be to eliminate orders completely.

We believe that the best way to accomplish changes in the milk marketing order program is through the Congress. Therefore, we suggest that the Congress consider establishing the goal of decreasing the federal role in milk pricing, and working with USDA to develop and adopt legislation necessary to accomplish that goal. If this is done, the Congress also should direct the Secretary of Agriculture to (1) monitor the conditions in the industry that result from changes to pricing policies and (2) act, if necessary, to help the industry adjust.

Mr. Chairman, that concludes my statement. We will be glad to answer your questions.

The CHAIRMAN. Are you getting anywhere?

Mr. CROWLEY. Well, I am up here today.

The CHAIRMAN. No, but with USDA.

Mr. CROWLEY. No. We were asking you to do that at the USDA.

The CHAIRMAN. OK. Senator Boschwitz, incidentally, just for scheduling purposes, I note that we did start 8 minutes late this morning, so we will go to 12:08. Go ahead.

Senator BOSCHWITZ. Regretfully, I am going to have to leave.

The CHAIRMAN. Stay.

Senator BOSCHWITZ. I would like to. Perhaps we took too long, Mr. Chairman, with our first witness who was here for about three-quarters of an hour.

I found the report very useful. Did you make an analysis, by chance, about the impact of State orders on the production of milk and on the removal by CCC?

Mr. CROWLEY. We did look at the California situation briefly in this job, and we also have another assignment that is looking at that right now, but has not been completed. We did know that California's costs of production are extremely low as compared to the rest of the country, mainly due to the fact that there are larger outfits there. They were able to spread their fixed costs over a much larger number of units.

Senator BOSCHWITZ. They are good dairy farmers.

Mr. CROWLEY. And they are very well managed farms there, yes. But we concentrated our efforts on the Federal marketing orders in this job. So, we did not really address the State ones.

Senator BOSCHWITZ. You did not look at the impact of State orders on the production of milk?

Mr. WOLDEN. No, sir, we did not.

Senator BOSCHWITZ. Well, I have read most of the report, and I found it to be very useful and a very fair-minded assessment. And I think it will be very helpful in the eventual solution of these problems. It would be my hope that we will have a more market-oriented system, and that we will not further regulate it, or further hinder it by putting up additional barriers and borders regionally or otherwise.

We are going to have to work that all out, but in the process of working it all out, I want to tell you gentlemen from the GAO that I think it was a very valuable and a very well-done report. With that in mind, and with the National Commission on Dairy Policy report that we recently received and with the report that will soon be forthcoming with respect to orders from USDA, I think we are building a basis for change. Some of the initial contentiousness that you see displayed here at the committee, I think will calm after awhile, and we will come to a reasonable conclusion about all of this. At least, that is my hope. Thank you, Mr. Chairman.

Senator CONRAD [presiding]. Welcome, Senator Daschle.

Senator DASCHLE. In the interest of time, I am going to ask you one question. I would be interested in knowing what you found with regard to marketing orders on the size of operation on dairy? The 1985 farm bill was very clear in stating its goal which was to ensure the viability of the small family farm. And we specifically mentioned dairy.

How do you see that goal as it relates directly to marketing orders? Have we seen a greater increase in size and style of operation? Are there more large incorporated systems as a result of marketing orders?

Mr. KNUTSON. I think that it is very clear from a large number of studies that there are substantial economies associated with larger size dairy farms. And that puts the family farm, the moderate size farm, at a substantial disadvantage. The large farms are more progressive. They tend to be better managed, and that is just one of the realities of the industry.

Senator DASCHLE. How can you justify or substantiate your claim that large farms are better managed?

Mr. KNUTSON. Well, if you have a farm that has an output per cow, as they do in California, of 3,000 pounds per cow higher than you do in the Upper Midwest, or in the average for the country as a whole, the only thing that I can attribute that to is better management. I mean higher yields to me mean better management.

Senator DASCHLE. Are you saying that you will never find a farm with as high a yield per cow as you do in the corporate farm?

Mr. KNUTSON. No, I did not say that. I did not say that.

Senator DASCHLE. That is the implication of your statement though.

Mr. KNUTSON. No, it is not.

Senator DASCHLE. Maybe you could clarify.

Mr. KNUTSON. You have farms in the Upper Midwest that have equally high output per cow, but you have to look at the averages, and what the averages say is that you have better management on larger size farms.

Senator DASCHLE. Well, I think that is a very unfair stereotype.

Mr. KNUTSON. OK.

Senator DASCHLE. I do not think you can say from averages that necessarily management is the only factor that may have determined output. You have just indicated that small farmers have on occasion just as high an input as corporate farms do. Is that not what you told me?

Mr. KNUTSON. Just as high an input? I do not understand.

Senator DASCHLE. Just as high an output, I mean, in production.

Mr. KNUTSON. I said that they have a higher yield, a higher output per cow. The larger farms have a higher output per cow——

Senator DASCHLE. Across the board.

Mr. KNUTSON [continuing]. By a considerable margin.

Senator LUGAR. Is that 100 percent of the time?

Mr. KNUTSON. No, I did not say 100 percent of the time. I said on the average.

Senator DASCHLE. Well, that is the problem that I get into. When you make statements like that for the record, you are really running into very deep trouble. I would hope you could hold back your personal judgment and make as good as an analysis based upon fact as you can, and I am not sure you can say factually that a corporate system will always out-produce a family farm when it comes to either management or production.

Mr. KNUTSON. I did not say a corporate system. I said larger farms, regardless of how they are organized, corporate or otherwise, tend to have lower costs of production.

Senator Daschle. Tend to. But that does not mean they always do.

Mr. Knutson. I did not say they always do.

Senator Daschle. Well, the way you made your first statement, it appears that you were making that as a statement of fact, and I think that that would be a very arguable statement, and I would disagree with it.

Mr. Knutson. Well, the numbers speak for themselves in that regard so——

Senator Daschle. Well, again, we are running out of time. Thank you, Mr. Chairman.

Senator Conrad. All right. There is a statement here that I think requires some focus on page 3 of your prepared statement Mr. Knutson: "Distance differentials provide production incentives in all regions of the country, except the Upper Midwest." And "The greater these differentials, the greater the production incentives and therefore the more likely that surpluses will rise high enough to cause the support price to fall. A combination of higher differentials and lower support prices can have a particularly adverse impact upon traditional milk-producing regions of the Upper Midwest, which receive little or no benefit from differentials, but which would be hurt by declines in the support price."

That really leaps out at someone like me who represents a State in the Upper Midwest. It causes me real concern. What are the relative levels of disincentive in various regions of the country as a result of these differentials? Did you do some comparative analysis for the various regions of the country in terms of incentive or disincentive for productions?

Mr. Knutson. Yes, we looked at profitability levels in different regions which is a function of cost of production and milk price received. And what you get is the higher profit regions have increased production the most. When you get increases in production, through the supply-demand adjuster in the price support program, you reduce the support price level which disadvantages the Upper Midwest the most.

Senator Conrad. On a comparative basis with other regions, which regions benefit the most?

Mr. Knutson. Well, the regions benefiting the most would be those that are the longest distance from the——

Senator Conrad. The most distant.

Mr. Knutson [continuing]. From the Upper Midwest; right.

Senator Conrad. Which would be Florida where we are seeing the biggest increase in production and Texas, right?

Mr. Knutson. Yes, yes. Northwest.

Senator Conrad. California has its own marketing orders.

Mr. Knutson. Yes. But they have a wide profit margin in California as well.

Senator Conrad. All right. These differentials are all spelled out in your study?

Mr. Knutson. Yes, yes, it is.

Senator Conrad. Well, Mr. Chairman, I think we have ended the questioning of this panel and can move to the next panel, Dr. Jerome Hammond and——

The **Chairman**. Before we do, I just want to ask Professor Knutson one question. Under these regulations, would the differential to Texas be changed?

Mr. **Knutson**. Yes, it would.

The **Chairman**. Thank you. Which way?

Mr. **Knutson**. It would be reduced.

The **Chairman**. Thank you. Dr. Hammond and Dr. Stammer.

STATEMENT OF JEROME W. HAMMOND, PROFESSOR, DEPARTMENT OF AGRICULTURAL AND APPLIED ECONOMICS, UNIVERSITY OF MINNESOTA, ST. PAUL, MN

Dr. **Hammond**. Mr. Chairman, thank you. I am pleased to be here and comment on this report. I was asked by our Senator, Senator Boschwitz, to report on the GAO report. I have a prepared statement that I will submit. I will try to keep my remarks to as close to the 5 minutes as possible.

I agree with the findings of the GAO report in that there are many outdated features of the Federal order system. Some of the reasons for the existence of that program no longer exist. However, I think one of the reasons for the program is understated or even overlooked in the report. It is one of the principal reasons for Federal orders—that classified pricing systems that are operated under them are a form of price enhancing, revenue enhancing, operation of markets. It is a very widely used technique, and it was very early recognized by dairy farmers and their cooperatives. In fact, these programs began prior to the Federal mandate or the Federal support for them. They existed because there was a large national market for manufactured dairy products but a local fluid milk market.

They are simply price enhancing, price discrimination. The approach is essentially identical to the practice of maintaining high domestic market prices and dumping a product that cannot be sold in the domestic market at that price in the world market, but in this case, the dumping is our own manufactured dairy products market.

The ability to maintain the pricing systems declined with improvements in motor transport, in the highway system, and milk refrigeration, and also as adverse court decisions eliminated some of the health barriers that supported some of these programs.

The **Chairman**. What were these? Sort of local health things that——

Dr. **Hammond**. Yes, the local ordinances.

The **Chairman**. That only the people in that area could——

Dr. **Hammond**. Could sell into that.

The **Chairman**. I see. OK.

Dr. **Hammond**. And those have been eliminated which put pressure on the pricing systems. And Federal authority was sought for them and gained with the legislation of the 1930's. One of the principal reasons that the programs have not come under more pressure is because of the existence of the Federal price support program. The price support programs prevent the Class I price increases, when they have occurred, from reducing manufacturing milk prices, below the price support. In effect, it merely increases the amount of CCC purchases as noted in the GAO report.

CONSEQUENCES OF ELIMINATION OF PRICING PROVISIONS OF FEDERAL ORDERS

Now what are the consequences of eliminating the provisions? These are outlined in the GAO report. I would have liked to have seen more figures indicating the kinds of adjustments, but in terms of the limitations on budgets and the time it takes to do these studies, I can understand that.

But I did review some of the works that have been done. There have been many studies done of actual impacts, not fitting exactly the scenarios outlined by the GAO, but I think they provide some insights.

I think another thing characterizes this study, it tends to understate or overlook some of the things that deregulation, the elimination of the classified pricing system, would not do.

I just want to point out three things that I think it would not do and are important to keep in mind.

First, elimination of federally enforced Class I differentials would not lead to a single price for milk within the various fluid milk markets of the United States. Milk processors' buying prices for fluid use milk could not fall to the manufacturing milk prices. Processors' buying prices would have to exceed manufacturing milk prices in order to attract milk into fluid uses. However, these price differences would be the competitive geographic structure of prices and they would be determined by costs of transporting sufficient supplies of milk into the fluid markets rather than any excess. The differentials would be substantially less than those now maintained by Federal orders and probably for all Federal order markets. They would be at a level that is just adequate to attract adequate fluid milk supplies from the producers located nearest the market—including a normal operating reserve. We would not observe the fluid milk shipments of 300 miles, plus, within markets that occur, for example, in the Chicago market to qualify plants for participation in the pricing scheme, and then back-hauling of the milk for processing into manufactured dairy products because it is not needed for the fluid market. I use Chicago as an example. It happens elsewhere.

Second, deregulation would not eliminate all price enhancing classified pricing schemes. Some would still continue to exist under State administration. Furthermore, producers' cooperatives would continue to exercise considerable market power in many milk markets, and may still be able to maintain class prices that reflect pure price enhancement, but probably less, and I am quite sure less than under the current Federal order system. Additionally, the cooperatives would continue to operate plants to provide milk for fluid processors and to make charges for the services provided to them.

Third, deregulation would not result in widespread use of milk concentrates for reconstitution into fluid products. Use of concentrates for reconstitution would become an economically feasible alternative only to meet temporary shortages in some markets. Assuming consumer acceptance of reconstituted milk products and/or the possibility of blending reconstituted milk with locally produced fresh fluid milk, reconstituted milk would be competitive only if the cost of importing fresh fluid milk exceeded cost of importing and using milk concentrates. The milk cost of the concentrates is the cost of the raw product, the cost of milk concentration, transport and storage of milk concentrates and reconstitution costs. Whereas, cost of fresh milk imports in fresh form would include only the transport costs. We have estimated in a 1979 study that the break-even point was about 500 miles. Within 500 miles, it is cheaper to assemble milk in the fresh fluid form. When you have to acquire milk from longer distances, it would arrive in the form of concentrates, and these would be the Southern and Southeastern markets when they have to import milk during seasonal shortages.

Now what about the price and quantity adjustments that would result from deregulation? With the current level of CCC purchases I propose what would happen if we dropped the pricing schemes under Federal orders immediately for this next year. With the 8 plus billion pounds of milk products we are now purchasing for price support, there is no way that the elimination of the Federal order program would eliminate all those purchases. There would be some reduction. The Class I prices prices would decline. The manufacturing price would remain the same.

The Class I price, however, would decline in all Federal orders with the elimination of Federal orders. An analysis that we did in the late 1970's, at the University of Minnesota, indicated that the differentials would decline by about $1 to $2.50. This was before we had the mandated increases in the Food Security Act of 1985. So I think the $1 to $2.45, $2.50 declines are the minimums that we could expect in the Federal order prices or classified prices as a result of the elimination of Government support for them. Now those reduced Class I prices are not fully reflected in the producer prices.

The producer prices are affected by the rate of utilization in the markets. A number of studies indicate that national milk price would decline by about 1 to 3 percent because of the elimination of Federal orders, but that those would vary considerably by regions—regional differences in some of the high utilization, high differential markets, probably by $1 to $2 declines in blend price, whereas in the Upper Midwest, probably not more than 10 cents a hundredweight.

So what about production of milk and consumption and therefore the CCC purchases? I estimated just by reviewing the data, not a rigorous analysis of the studies that have been done, that we would probably observe a reduction in milk supply of about a one-half a percent to 1 percent nationally.

Fluid consumption would increase somewhat, but very little. So we would probably see declines in CCC purchases somewhere in the range of 800 million pounds to 2½ million pounds in CCC purchases because of this elimination of Federal orders.

Thus, in summary, fluid milk markets would continue to maintain price differentials with the elimination of pricing under Federal orders. In terms of the impacts on CCC purchases, they definitely would occur. I am generally in agreement with the recommendations and findings of the GAO report. The program has serious regional biases, which they outlined, and they should be corrected.

And they outline a program for doing that. Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Dr. Hammond follows:]

STATEMENT OF JEROME W. HAMMOND, PROFESSOR, DEPARTMENT OF AGRICULTURAL AND APPLIED ECONOMICS, UNIVERSITY OF MINNESOTA, ST. PAUL

The U.S. dairy industry has been modelled and analyzed in innumerable economic studies--many with the objective of describing how the industry would operate in the absence of federal programs or major changes in federal programs, i.e. the federal milk marketing order program and the federal price support program. The GAO report, "Milk Marketing Orders--Options for Change" (1988)(1) is another is this long list of studies. My purpose this morning is to provide you with my assessment of the report. I will:

-discuss the major proposition of the report, that the federal order system is not appropriate for the dairy industry of today and

-examine some of the options for change that are recommended in the report.

Why do we have federal orders?

The GAO report states that federal milk marketing orders are an outdated system because:

1. the grade A component of the Class I differentials is far in excess of the added cost of producing grade A milk versus grade B (manufacturing) milk.

2. the distance components of the Class I differentials are no longer appropriate in that they neither reflect milk production cost differences nor costs of obtaining alternative milk supplies, and

3. the 'down allocation' and' compensatory payment' provisions of federal orders effectively preclude more efficient means of moving milk.

These propositions, for the most part, have been valid since the onset of federal milk orders. The conventionally accepted rationale for federally regulated prices in fluid milk markets include: the weak bargaining position of milk producers vis a vis milk processors in the major fluid milk markets, milk is a highly perishable product that must be sold immediately by farmers for further processing, daily and seasonal imbalances of demands and supplies of fluid milk require handlers to hold necessary operating reserves that eventually are disposed of in less remunerative uses and, consequently, have a depressing effect on market prices. Its argued that these conditions caused highly unstable prices, uncertainty of market outlets for producers, and monopolistic exploitation of producers by milk buyers, or the condition of disorderly marketing frequently cited by proponents of federal orders.

Though partially valid as the basis of federal order pricing, the preceding arguments were and still are used to mask the primary basis for classified pricing of milk. That is, classified price systems are revenue (and average price enhancing. With the relatively isolated character of supply areas for most city fluid milk markets till the 1920's, the existence of a large national market for manufactured dairy products, and frequently with the assistance of restrictive local health codes, an ideal opportunity existed to practice revenue enhancing price discrimination. Dairy farmers were quick to realize the potential gains and some classified pricing schemes were developed early in this century. The procedure works because of different price responses from sales in fluid markets from those for the same sales quantity in the national manufactured dairy products market. The approach is identical to the practice of maintaining high domestic market prices and dumping product that cannot be sold at that price in the world market, but the dumping market is our own manufactured dairy products market.

The ability to maintain the pricing systems declined as improved motor transport, highways, milk refrigeration, adverse court decisions on restrictive health ordinances, and more and more milk producers shifted from manufacturing grade milk to fluid grade to obtain the higher average prices. The situation was aggravated by the 'Great Depression'. Federal support for the programs was obtained under the Agricultural Adjustment Act of 1933 and the Agricultural Marketing Agreements Act of 1937. Nevertheless, technology, very unequal distribution of the benefits of classified prices while their costs are imposed on non-regulated milk producers or on markets with very low Class I use such as Chicago and the Upper Midwest as noted in the GAO report and adverse court decisions on restrictive health ordinances continued and intensified pressures on the program.

Administrators of the program have responded to the pressures by consolidation of orders, expansion of order areas, and for many years, until the Congressional requirement in Food Security Act of 1985, refusal to increase Class I differentials. More importantly, pressure for federal milk order reform have been reduced because the federal price support program has prevented Class I price increases, when they have occurred, from reducing manufacturing milk prices. Rather, the adjustments are increased CCC purchases, as noted in the GAO report.

Consequences of Elimination of Pricing Provisions of Federal Orders

The GAO report specifies a number of possible federal order changes. Essentially, they are a sequence of modifications until the orders no longer establish minimum prices for milk, i.e. a procedure for deregulation. Rather than comment on each step, I'll focus my remarks on the probable consequences of complete price deregulation.

The GAO report, like many of the studies of milk deregulation, (Ippolito and Masson, Hutton and Helmberger, Brooks, and others)(2) tend to overlook or underemphasize some important characteristics of deregulated milk markets. These are the things that deregulation would not do.

First, elimination of federally enforced Class I differentials would not lead to a single price for milk within the various fluid milk markets of the U.S. Milk processors' buying prices for fluid use milk could not fall to the manufacturing milk prices. Processors' buying prices would have to exceed manufacturing milk prices to attract milk into fluid uses. However, these price differences would be the competitive geographic structure of prices that would be determined by the costs of transporting milk to the fluid markets. The differentials would be substantially less that those now maintained by federal orders. They would be at a level that is just adequate to attract adequate fluid milk supplies from producers nearest the market (including a normal operating reserve). We would not observe fluid milk shipments of 300 miles, plus, that occur in the Chicago market to qualify plants for participation in the pricing scheme, and then back-hauling of the milk for processing into manufactured dairy products because it is not needed for the fluid market.

Second, deregulation would not eliminate all price enhancing classified pricing schemes. Some would still continue under state administration. Furthermore, producers' cooperatives would continue to exercise considerable market power in many milk markets, and may still be able to maintain class prices that reflect pure price enhancement, though much less than are currently maintained by federal orders. Additionally, they would continue to operate plants to provide milk for fluid processing firms and would be making charges for those services.

Third, deregulation would not result in widespread use of milk concentrates (nonfat dry milk, butterfat products, or fluid milk concentrates from reverse osmosis, ultrafiltration, or evaporation) for reconstitution into fluid products. Use of concentrates for reconstitution would become an economically feasible alternative to supplement local fresh fluid milk supplies during shortages in some markets. However, this alternative would be economically feasible only when long-distance shipments of milk are required. Assuming consumer acceptance of reconstituted milk and/or the possibility if blending of reconstituted milk with locally produced fresh fluid milk, reconstituted milk would be competitive only if cost of importing fresh fluid milk exceeded cost of importing and using milk concentrates. Keep in mind that the cost of milk concentrates would include: the cost of the raw milk, cost of milk concentration, transport and storage of milk concentrates and reconstitution costs. Cost of fresh milk imports would include only raw milk cost and transport cost. In our study of reconstituted milk in 1979, we estimated the break-even distance to use reconstituted milk to be about 500 miles.(3) No market that has adequate supplies of milk within a radius of 500 miles would use reconstituted milk. Furthermore, even deficit milk markets would not concentrate and reconstitute milk that is produced within 500 miles. Thus, reconstituted milk would be used principally in southern and south central U.S. and, then, only to meet the temporary or occasional milk shortages in fluid milk supplies.

Price, production, and consumption consequences of eliminating, or substantially reducing Class I price differentials under federal milk orders would, as noted in the GAO report, vary substantially among regions of the U.S. Impacts would change if significant changes were also made in the federal price support program. For the following remarks, I'll assume continuation of the current price support program.

Manufacturing milk prices, given the level of CCC dairy product purchases that we now have, 8+ billion lbs. annually, would be essentially unaffected by elimination of Class I differentials. Even with a decline in national milk production and increased fluid milk consumption that would result from deregulation, the net effect would still be insufficient to eliminate the need for substantial CCC purchases to maintain the current support price for manufacturing use milk. If CCC purchases declined to very small levels or were eliminated by a supply control program, then, elimination of Class I differentials would result in rising manufacturing milk prices.

Class I prices would decline in all federal orders with elimination of federal orders, but as noted above, fluid milk prices would necessarily continue above manufacturing milk prices. Buxton's 1977 analysis of eliminating federal orders indicated regional declines in Class I differentials of $.95 to $2.45 per hundredweight. Since then, Class I differentials were increased by as much as $1.03 by the Food Security Act of 1985. I can only conclude that Buxton's estimates are the minimum reductions that could be expected. Largest declines would occur in eastern and southern federal order markets, as much as 17 percent.

As a result of reduced Class I differentials, producers blend prices would also be reduced. Nationally, the all milk price decline would probably be in the range of 1 to 3 percent.(4) Greatest reductions in producer prices would occur in those markets with largest changes in differentials and highest utilization of milk in fluid products. Eastern and southern markets where differentials would decline by $2.00 or more and fluid utilization exceed 50 percent would experience blend price reductions of $1.00 to $2.00 per hundredweight. The decline in the upper midwest would probably be less than $.10 per hundredweight because of the very low utilization of milk in fluid uses. It is likely that fluid milk markets would experience more seasonal price variation in response to seasonal milk supply changes.

The milk price changes would generate changes in milk production and commercial use of milk products. However, both milk demands and supplies are very unresponsive to price changes, the quantity adjustments are very small compared to price changes. Total national milk production would decline by .5 to 1 percent with practically no change in the Lake States markets and larger declines in the east and south. Commercial use of manufactured dairy products would be unaffected because the manufacturing milk prices is unchanged. Fluid milk consumption would increase in all regions of the U.S because of reduced Class I prices. Based on the studies by Hammond, Buxton, and Thraen and by Hutton and Helmberger, that I have cited in this report, total U.S fluid milk use would increase from .2 to 1.0 percent. Increases for the southern region of the U. S. could be as high as 3.0 percent.

In summary, the GAO reports cites some important consequences of eliminating Class I pricing by federal orders. I've attempted to elaborated on those changes and to note impacts that are often overlooked in the debate on federal orders. In particular, that differentials for fluid use milk would continue to exist in the absence of federal regulation and that reconstituted milk is only economically rational for long-distance milk shipments. It will not displace nearby producers of fresh fluid milk. In terms of impacts on CCC purchases, my review of the data indicates reductions ranging from 1 to 2.5 billion pounds annually. Generally, I'm in agreement with the findings and recommendations of the GAO report. The federal order program has serious regional biases which need to be corrected.

FOOTNOTES

[1] _______________, "Milk Marketing Orders--Options for Change", Report to Congress, GAO/RCEd-88-9, U.S. General Accounting Office, Washington, D.C. March 1988.

[2] Ippolito, R.A. and Masson, "The Social Cost of Government Regulation of Milk," J. **of Law and Economics**, 21(1978); Hutton, P. and P. Helmberger, "Aggregative Analysis of U.S. Dairy Policy," R3191, The Research Division of the College of Agricultural and Life Sciences, University of Wisconsin, Madison, 1982; and Brooks, K.M. "Dairying and Dairy Policy in the 1980's," AEI Occasional Papers, The american Enterprise Institute for Public Policy Research, Washington, D.C. 1984.

[3] Hammond, J.W., B.M. Buxton, and C.S. Thraen, "Potential Impacts of Reconstituted Milk on Regional Prices, Utilization, and Production," Station Bulletin 529, Agricultural Experiment Station, University of Minnesota, 1979, pp. 5-11.

[4] Based on analyses of Buxton B.M., op. cit. and Hutton, P. and P. Helmberger, op. cit.

The CHAIRMAN. Dr. Stammer, even though Dr. Hammond has used your time, I do want to hear from you, and your statement was important, too, Dr. Hammond. I tend to disagree with your conclusion of support of the GAO report, but I appreciate having it in the record. Dr. Stammer, please. It is good to see you again. You can stay here, Dr. Hammond until we see whether there are going to be questions. Go ahead.

STATEMENT OF RICHARD W. STAMMER, SENIOR VICE PRESIDENT, ECONOMICS AND COMMUNICATIONS, AGRI-MARK INC., METHUEN, MA

Dr. STAMMER. I am pleased, Senator, to have the opportunity to testify before this committee today on issues of importance to our farmer members in New England.

I would first like to address the GAO market order study. Let me state at the outset gentlemen, that the report is a very disturbing document to me in the sense that I thought the General Accounting Office was supposed to examine issues in an unbiased and professionally competent manner. The report is neither an unbiased nor professionally competent piece of work and I can only hope that the shortcomings were due to a lack of understanding of the Federal order program rather than a deliberate bending of the facts. Prior to joining Agri-Mark, I spent 11 years as a professor of agricultural economics at Rutgers University, and if this study had been done by one of my students, I would have flunked him—because the study started out with a conclusion and then bent the facts to support the conclusion. It then brings out several options to solve the problem that it made up in the first place.

The CHAIRMAN. Dr. Stammer, do not feel you have to sugar-coat.

Dr. STAMMER. I am not. [Laughter.]

After everybody who has come before, I really look like the black sheep here, I guess.

The totally unsupportable case that the report tried to make was that Federal order provisions have contributed to our national surplus production problems. As was very adequately pointed out by the Department of Agriculture—Class I differentials had not been changed during the periods under study, which compared a period of surplus to one of no surplus. In fact, Class I differentials declined as a proportion of the total price of milk received by producers during that period. Hence, a valid argument cannot be made that Class I differentials were even partially responsible for our surplus problems. Anyone knowledgeable with dairy programs could have told the study group that the surplus was caused by the relation of support price to the cost of producing milk during the study period. It was a support program problem, not a Federal order problem.

Since the basic problem on which the report's recommendations are founded is invalid, it is really not necessary to go into each of the recommendations, but I will make a few observations on the study:

One, the study constantly tries to equate Class I differentials to the cost of producing milk. Obviously, they found little relationship because the system was set up to move milk from where the producers are to where the consumers are and not to reflect the cost of production.

Two, the report ignores the basic economic fact that milk is worth more the closer it is to major population centers.

Three, the study correctly states that Class I differentials have not been updated, they cover about one-half of the cost of moving milk from major production areas to consumption areas. They also correctly state that "if the differential is high enough to cover transportation costs, it can also provide an incentive for moving milk into a market." However, the conclusion was not to raise differentials, but to eliminate them—which is most curious.

Four, the report knocks the classified pricing system as being a price discrimination system. Gentlemen, price discrimination exists all around us—I paid twice as much for my airline ticket this morning than the person next to me, basically because I was a business traveler. What price discrimination does in the Federal order system is it allows producers to sell more product commercially for any given level of farm income. That means for any level of farm income it reduces Government costs. If you eliminated the price discrimination aspect of the system, Congress would be faced with a difficult choice—increase Government purchase costs or further reduce farm income.

Five, when the study discusses the Southwest, it appears to ignore the fact that the State that makes up 86 percent of Southwest production, California, is not even in the Federal order system. How could they miss this?

I will skip over my sixth observation of the report and last let me say that I think the crux and purpose of the report is illustrated in the long-run impact tables. For what I call their four major recommendations, they show that the impacts would be to increase disorderly marketing, decrease local supplies, decrease producer receipts nationally, and increase producer receipts in the Minnesota-Wisconsin area. They fail to mention that they would also lower producer asset values and put many dealers out of business except in Minnesota and Wisconsin. It appears to me that unless you are from Minnesota or Wisconsin, you would see little socially redeeming value in the recommendations, and, even if you are from Minnesota or Wisconsin, you would have to question if the gains are worth the total disruption of the national dairy industry.

If we have some time, Senator, I would like to make some comments on S. 1869. I would like to state that Agri-Mark strongly endorses the spirit of Senate bill 1869—that spirit being that in our national dairy policy and in trying to address our national surplus problems, we must also consider the fact that the dairy industry differs greatly region to region. Florida, Wisconsin, California, Texas, Vermont and other States all have very different production and market situations. When Senator Leahy announced this bill at our Agri-Mark annual meeting, he made it clear that this was a starting point to open up discussion on this important issue, but he was open to suggestions from the industry on other ways to address this issue.

The Senator laid down the challenge to the industry—if you do not like the bill, give me another one that you do like, but we cannot just stonewall and ignore the issue—Agri-Mark applauds his effort.

I will not go into the basic problem. I am sure we are all familiar with that. Basically, the fact that we have a real difference in markets and cost of production around the regions.

It is Agri-Mark's basic belief that the price support program should be a national program and the Federal order program should be used to address regional issues. Unfortunately, in the last several years, the Federal order program has been administered in such a way that it has not been allowed to serve its regional role. Part of this is due to the fact that the administration seems to have confused the role of the two programs. We can also see, obviously, from the GAO report that there are those people who would like to get rid of the Federal order program. If the Federal order program had been allowed to function to service the needs of specific markets, I do not think we would be here today talking about ways to regionalize the support program. The best solution to the regional problem is probably in the revitalization of the Federal order program.

There are other ways to address this national problem and have a national support system such as having targeted whole herd buyouts. Why would you buy product out of an area where the markets are in balance, buy producers out of business, when all that happens is cause disruption in those markets and leave other markets still making a lot of surplus production?

So maybe we should target a buyout. Target it to the areas where more surplus production is being produced.

The CHAIRMAN. How about targeted diversion?

Dr. STAMMER. Or targeted diversion. Any of those things that would not really hurt producers or consumers in those areas, but when you buy milk out of areas like the Southeast or New England, you seriously disrupt the whole market and hurt consumers in those markets.

The CHAIRMAN. If we simply kept on the way we are doing, no real changes in the marketing orders, continuation of what appeared to many to be inevitable price cuts, what does that indicate for dairying in this country? Does that say that we will have a viable dairy industry across the country in virtually all areas of the country? Or do we end up concentrating just a couple places?

Dr. STAMMER. No, we will certainly not have it all across the country, Senator. Certainly we would have virtually no dairy industry left in New England. One of the problems in New England, when you cut the price to farmers in Wisconsin, that may drive one farmer out of business which is difficult for that farmer, but a new farmer can go in and buy the farm because it has a lower asset value.

The asset value is tied to the price of milk. In New England when you drive a farmer out of business because of low milk prices, another farmer cannot come on his farm because the asset value is tied to something else other than the price of milk. It is tied to ski areas. So that farmer will not be replaced after he is driven out of business.

And as that goes on, you just reduce your critical mass of farmers until the people left have to pay a higher cost for feed, higher cost for transportation, and it is just a snowballing type problem.

We would still have, in the Northeast, concentrations probably in New York and Pennsylvania. But you would certainly concentrate it in certain pockets around the country.

The CHAIRMAN. And those would be ones that would support their own processing plants or their own distribution centers and so forth. Is that correct?

Dr. STAMMER. Right. And it would also mean the consumer in Boston would be paying more for milk.

The CHAIRMAN. Dr. Hammond, do you disagree with that thesis?

Dr. HAMMOND. Yes, I do.

The CHAIRMAN. Why?

Dr. HAMMOND. The manufacturing milk industry, which is the one where you are aiming at, is using for support a national industry. It is not one that is easily compartmentalized. I think there would be apart from any philosophical issues about supporting or not, I think just the practical issues of trying to operate such a regional program would be horrendous.

If you, for example, reduce the price in the Northwest because they produce so much surplus, what would happen? Processors and buyers would quickly go to the Northwest to buy their milk, and then you would have surplus in New England or in other areas of the country. It seems to me it would just be practically an impossibility to make it operate.

But further than that, this is a national industry. We have the problems of diversion that are created now because of the Federal order, diversions of interest. This would just increase that enormously. It is not a set of States or group of producers here or there that are causing the problem. It is a problem for the entire industry.

The CHAIRMAN. Dr. Stammer.

Dr. STAMMER. As I said, I did not quite finish my statement. But I said in the end of the statement that a lot of people here will say that they are opposed to S. 1869 because it regionalizes the support program, and they believe in the national support program, and I would say that Agri-Mark agrees in the national support program and thinks it is difficult to regionalize that program.

I did give some other alternatives to the regional issue: making Federal orders work better; targeted buyouts and things like that, which Agri-Mark probably thinks is better, and that is what the Senator asked us for, some alternatives. But we also feel that if those do not work, we have got to do something.

The CHAIRMAN. As I noted when I introduced the legislation, I want alternatives if there are any, but I do not want to see a situation where dairy disappears in New England or in any other part of the country. Unlike things that are highly dependent on the weather or topography, the citrus industry being an example, there is no reason why dairy cannot be spread throughout the country. There are other parts of our agricultural production that can be spread throughout the country.

I am very concerned about not only the economic, but the national security situation where we have any part of our agriculture just concentrated in one place, or if we eventually had all our agriculture concentrated in one or two parts of the country. I think it creates a real national security problem for us.

Senator Conrad, did you have any questions?

Senator CONRAD. No. In the interest of time, Mr. Chairman, I will forgo the chance to ask questions.

The CHAIRMAN. Thank you. Gentlemen, I thank you both for being here. Your whole statements, of course, will be part of the record, and I do appreciate your being here.

[The prepared statement of Dr. Stammer follows:]

TESTIMONY OF DR. RICHARD W. STAMMER
BEFORE SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
MAY 11, 1988

My name is Richard W. Stammer and I am the Senior Vice President of Economics and Communications for Agri-Mark Inc., headquartered in Methuen, Massachussetts. Agri-Mark is the largest dairy cooperative in the New England Market, marketing about 2.5 billion pounds of milk a year.

I am pleased to have the opportunity to testify before this committee today on issues of importance to our farmer members.

I would first like to address the G.A.O. market order study. Let me state at the outset gentlemen, that the G.A.O. report is a very disturbing document in the sense that I thought the General Accounting Office was supposed to examine issues in an unbiased and professionally competent manner. The report is neither an unbiased nor professionally competent piece of work and I can only hope that the shortcomings were due to a lack of understanding of the Federal Order Program rather than a deliberate bending of the facts. Prior to joining Agri-Mark, I spent 11 years as a professor of Agricultural Economics at Rutgers University, and if this study had been done by one of my students I would have flunked him - because the study started out with a conclusion and then bent the facts to support the conclusion. It then brings out several options to solve the problem that it made up in the first place.

The totally unsupportable case that the report tried to make was that Federal Order provisions have contributed to our national surplus production problems. As was very adequately pointed out by the Department of Agriculture - Class I differentials had not been changed during the periods under study, which compared a period of surplus to one of no surplus. In fact, Class I differentials declined as a proportion of the total price of milk received by producers. Hence, a valid argument cannot be made that Class I differentials were even partially responsible for our surplus problems. Anyone knowledgeable with dairy programs could have told the study group that the surplus was caused by the relation of support price to the cost of producing milk during the study period. It was a support program problem, not a Federal Order problem.

Since the basic problem on which the report's recommendations are founded is invalid, it is not necessary to go into each of the recommendations. Instead, I will make some observations on the study:

(1) The study constantly tries to equate Class I differentials to the cost of producing milk. They find little relationship because the system was set up to move milk from where the producers are to where the consumers are and not to reflect cost of production.

(2) The report ignores the basic economic fact that milk is worth more the closer it is to major population centers.

(3) The study correctly states that since Class I differentials have not been updated, they cover about 1/2

the cost of moving milk from major production areas to consumption areas. They also correctly state "if the differential is high enough to cover transportation costs, it can also provide an incentive for moving milk into a market". However, the conclusion was not to raise differentials but to eliminate them - most curious.

(4) The report knocks the classified pricing system as being a price discrimination system. Gentlemen, price discrimination exists all around us - I paid twice as much for my airline ticket this morning than the person next to me basically because I was a business traveler. What price discrimination does is it allows producers to sell more product commercially for any given level of farm income. That means for any level of farm income it reduces government costs. If you eliminated the price discrimination aspect of the system , Congress would be faced with a difficult choice - increase government purchase costs or further reduce farm income.

(5) When the study discusses the Southwest, it appears to ignore the fact thay the state that makes up 86% of Southwest production, California, is not even in the Federal Order System. How could they miss this?

(6) My favorite quote in the report is in the section where they are attacking down allocation provisions. The report states - "Down allocation provisions . . . eliminate any financial incentive for shipping milk into a market where it is not needed". Frankly, I find it hard to see that as a problem with the system.

(7) Finally, let me say that I think the crux and purpose of the report is illustrated in long run impact tables. For what I would call their four major recommendations they show that the impacts would be to increase disorderly marketing, decrease local supplies, decrease producer receipts nationally and increase producer receipts in the Minnesota/Wisconsin area. They fail to mention that they would also lower producer asset values and put many dealers out of business except in Minnesota and Wisconsin. It appears to me that unless you are from Minnesota or Wisconsin, you would see little socially redeeming value in the recommendations and, even if you are from Minnesota or Wisconsin, you would have to question if the gains are worth the total disruption of the National Dairy Industry.

I would now like to make some comments on Senate Bill 1869. I would like to state that Agri-Mark strongly endorses the spirit of this bill - that spirit being that in our national dairy policy we must address the fact that across this great country of ours the local dairy market situation varies vastly from region to region. Florida, Wisconsin, California, Texas, Vermont and other states all have very different production and market situations. Somehow in our policy prescriptions for solving a national dairy problem we must recognize these regional differences so producers can be treated equitably and we can minimize disruptions in commercial dairy markets. When Senator Leahy announced this bill at the Agri-Mark annual meeting he made it clear that this was a starting point to open up discussion on this important issue but he was open to suggestions from the industry on other ways to address this issue.

The Senator laid down the challenge to the industry - if you do not like this bill give me another one that you like but we cannot just stonewall and ignore this issue - Agri-Mark applauds his effort.

I am sure you are all familiar with the basic problem and I will not bore you with statistics, but will summarize it as follows: We have the juxtaposition of situations where we may have a national surplus of dairy production but that surplus varies greatly by region. Some regions such as the East Coast sell very little to the government, in others such as the Upper Midwest, the proportion of sales to the government is fairly well aligned with their proportion of national production, and finally we have other regions such as the Far West whose proportion of C.C.C. purchases greatly exceeds their proportion of national production. The question is - when some policy is adopted to solve the national surplus problem is it equitable to treat all these regions equally?

Agri-Mark's basic belief is that the price support program should be a national program and the Federal Order program should be used to address regional issues. Unfortunately, in the last several years, the Federal Order program has been administered in such a manner that it has not been allowed to serve its' regional role. Part of this is due to the fact that the Administration seems to have confused the role of the two programs. We can also see from the G.A.O. report that there are those who would like to do away with the Federal Order Program. If the Federal Order program had been allowed to function to service the needs of specific markets, I do not think we would be here today talking about ways to regionalize the support program. The best solution to the regional problem is probably in a revitalization of the Federal Order Program.

There are other ways to address the problem while still maintaining a national support program. Since, I think price is a good long run means of balancing supply and demand but a very ineffective way to balance it in a shorter 1 - 3 year period, and we can achieve this shorter run balancing best through a voluntary supply management program such as Whole Herd Buyout - why not target the buyout? That is, buyout more milk in regions where there is a surplus than in regions where the supply is in reasonable balance with commercial demand. Does it make sense to buy production out of an area where markets are in balance? The result of that is that dealers have to raise prices to farmers and consumers to attract more milk into the area - causing a lot of market disruption while other regions continue to sell to the C.C.C.. Such a targeted buyout does not disadvantage either producers or consumers in any region.

I know many people will probably testify here today in opposition to S1869 on the basis that it regionalizes the support program, which, by the way, is already regionalized since California operates under different rules than the rest of the world, and I represent to you that I have offered two other viable alternatives to the problem, as Senator Leahy requested, that do not regionalize the support program. Agri-Mark itself would prefer these alternatives due to some of the problems inherent in regionalizing the support program. However, if the problem of regional inequities cannot be addressed in one of these alternative ways, we then feel it must be addressed directly through a bill such as S1869.

The **Chairman**. Our next panel is made up of Tom Trantham, Harry Shupe, Albert Ortego, George Hildre, Cheryl Cook and Robert Rumler.

As I said, I was going to recess at 12:08 which would somewhat curtail your testimony, but Senator Conrad has been gracious enough to agree to stay till 12:30. So that will give us a little bit more flexibility.

You have heard the discussions here. Your whole prepared statements will be put in the record. What I would suggest—you are perfectly welcome to proceed anyway you want—you should probably have two things in mind. Is there any reaction you want to make to what you have heard so far? And second, if you were here writing this policy, what would you write? So Tom, it is good to see you.

Mr. **Trantham**. Thank you, sir. Pleasure to be here. Thank you very much for asking.

Senator **Conrad**. Mr. Chairman, before Mr. Trantham begins, might I make an observation? When I look at the GAO report, there is something that disturbs me. It disturbed me when I read it, and I just think I ought to express publicly that my understanding is that when GAO is asked to do an analysis, it ought to be on a factual basis, looking at the alternatives, analyzing the alternatives.

But I have never seen before—maybe I have missed it—a GAO report that expresses what appears to me to be a personal ideological position. Frankly, I think it is totally inappropriate. I do not think GAO has any business taking a position based on ideology or philosophy. That is not the business of the General Accounting Office.

I must say I am very disturbed by what I see happening in this report. It seems to me their business is to analyze on a factual basis what the alternatives are. That is their business. We do not need people from the General Accounting Office expressing their political point of view, and I do not care what the political point of view is. I just think that it needs to be stated for the record that there is something here that really troubles me.

The **Chairman**. Well, I agree with the Senator, and I expressed my own concern earlier that while I am usually GAO's biggest fan, even when they have come back with reports that have disagreed with positions I have taken, I have been strongly supportive of them. I am not supportive of them in this report, and I think that this report left a great deal to be desired, and I was very, very disappointed in it, among other reasons for the reasons the Senator from North Dakota has raised.

Tom, I have seen you here. I have seen you in Vermont. I have seen you back here again. Good to see you again.

Mr. **Trantham**. Thank you, sir. It is a pleasure to be here.

The **Chairman**. As you know, I am always pleased to see you.

Mr. **Trantham**. Thank you very much.

STATEMENT OF TOM TRANTHAM, PRESIDENT, UNITED FARMERS ORGANIZATION, ON BEHALF OF THE NATIONAL SAVE THE FAMILY FARM COALITION, PELZER, SC

Mr. TRANTHAM. If I may, I would like to make one comment on this GAO statement about the large herd, if I may.

The CHAIRMAN. Go ahead.

Mr. TRANTHAM. The large herd that is being more productive, higher producing herd, well, at what cost? First of all, the highest producing herds in the world, in the Nation, is in the Northern and the Midwestern part of our country. We select from the highest, high producing cows in the world the bulls to be used for artificial breeding. You will find the majority of them do come from the North and the Midwest because of the supreme genetics and ability to produce milk.

A cow produces milk not by the size of the barn she lives in, but by how the man who feeds her and cares for her. That is where you get milk, by feed, not by the size of her barn or facilities. So I have a 15-year-old cow that produces 25,000 pounds of milk. I almost kiss her every morning when I go in.

The CHAIRMAN. You better.

Mr. TRANTHAM. You bet. But the size of the herd, the size of the dairy, as a matter of fact, the reason that they have a higher herd average is that they have a very large slaughter or culling rate, and by doing that because of mismaintenance to their animals due to bad feed and such as that, they cull them at a much earlier life. They do not have any 15-year-old cows in their herds. And through that you are taking only the prime out of the cow, taking her highest producing years, and then having her destroyed, and when you figure that economically over a long period of time, you will find that is not economical. When you have a 15-year-old cow that produces for you 25,000 pounds of milk, you ought to kiss her in the morning.

I will go on with this now if it is OK. First of all, thank you very much for having me here, sir.

I come before you today, as a small South Carolina dairy farmer, but this small family farmer's last month's milk check was $18,689.87. Not only did I spend this amount of money in the region where I live, but I also produced a quality product that was fit for a king or even a Senator, Senator Leahy. I left my cows today to represent working dairy farmers across the country who believe dairy policy needs to be written by those who get up before daylight to milk the cows. As dairy farmers, we have been meeting in different regions around the country for the last 3 years because our problems have continued to worsen since 1980. We will continue this campaign and process, breaking down the barriers between the different regions, because we believe it is time for dairy farmers to unite and be heard.

On my farm, because of my family's continued will to survive, we have increased our milk production from 58 pounds a day per cow to 65 pounds in the last 3 months. Our milk check, however, was less than it was before because of the 50 cent cut in January. Instead of being able to reward my family for our efforts, it was as if we were spit in the face. We took this 50 cent cut for producing over the 5 billion pound trigger set in the 1985 farm bill. However, shortly after this, USDA states that the food assistance programs will no longer be able to receive cheese and milk because the surplus—surplus—I do not quite understand that word—it is not what I thought it was—has been reduced. We wish to call for an oversight hearing to review and investigate the seemingly unjustified cut, and its relationship to the food assistance programs.

One, everyone must understand that by reducing the price to the farmer encourages him to increase production to meet this reduced income.

Two, what we need is a fair price set at 75 percent of parity with a supply management to reduce the—I have to use that word—surplus, and—by the way—without putting one cow on the beef farmer's market. How is this? Gentlemen, there is not a dairy farmer in this country today, that could not through their management practices, reduce their production of milk in this Nation 5 percent over a 5-day period. Five days I can cut—I can do better than that. I want you to give me some lead way because I do not want you to say I cannot. But in 5 days every dairy farmer in the United States, if he could have a fair price for his product, but instead of reducing his price, he has to increase his production. That is it. Seventy-five percent parity price and a regional base allotment program, dairy farmers—at the farm level—can produce the needed amount of high quality product to feed this Nation.

Three, Senator Leahy, we support you and your call for the Dairy Farm Protection Act, that includes a regional approach to correcting the surplus and deficit problems. A regional dairy plan will also produce high quality local product less expensively. It also ensures the dairy farmers will continue to be able to support the local tax base and local merchants. But, we believe parity pricing and supply management are the vital key to the long-term success of any fair regional dairy plan.

Four, we would like to go on record as being aware of the $1 million Dairy Commission Report called for in the 1985 farm bill. Having testified before this Commission and having talked with farmers across the country, we do not feel that this report truly represents what working dairy farmers want in a national policy. We want a fair price, supply management, and a regional approach.

Almost 60 percent of their testimony brought that out, and a lot of the farmers were not aware of what a parity program and a base would be. A lot of the Upper Midwest farmers, which I have met with, Wisconsin, Minnesota, and many other Northern farmers, and after understanding the base and how it works, we have left our meetings with full support.

But again, Senator Leahy, we are in support, and we are proud of what you are doing, and we hope to be able to work with you, sir.

The CHAIRMAN. Thank you very much. One of the things I have done for the 14 years I have been in the Senate is to go around the State and chat with farmers. While this is not a scientific way of doing it, I am absolutely convinced in discussions I have had there that simply bringing down the dairy price supports is not a way to cut production.

The typical farmer has mortgage payments, electric payments, equipment payments, and other fixed costs that remain the same no matter what. And if you have *x* payment, and you cut 10 percent of *x* out in your dairy price support, then how do you make those payments? You just increase production by 10 percent. You said you could decrease production by 5 percent in 5 days.

Of course, by the same token, you can increase production. And that is exactly what is happening, and now we have the situation where people are practically killing themselves working and trying to keep up with price reductions, exacerbating the problem.

I would also note when you talk about the surplus foods, TEFAP, school lunch and other food assistance programs, we had testimony here from the Department of Agriculture that there is no poverty caused hunger in this country. That is about the most outrageous, off-the-mark comment, I think I have ever heard. Any one of us could walk out this door and go a few blocks and see poverty caused hunger just as you could in your hometown, mine, or anywhere else.

Mr. TRANTHAM. Over 200,000 people are on the food program in South Carolina.

The CHAIRMAN. One quarter of the children in this country are in poverty or are hungry. One quarter of the children. We are trying to vie with some of the worst of the Third World nations in that respect.

[The prepared statements of Mr. Trantham and the National Save the Family Farm Coalition follow:]

May 11, 1988

STATEMENT OF
TOM TRANTHAM, (PRESIDENT OF UNITED FARMERS ORGANIZATION),
ON BEHALF OF THE NATIONAL SAVE THE FAMILY FARM COALITION

Representing the National Save The Family Farm Coalition, (NSFFC), I am pleased to submit this statement on behalf of our member organizations.

I come before you today, as a small S.C. dairy farmer, but this small family farmer's last month's milk check was $18,689.87. Not only did I spend this amount of money in the region where I live, but I also produced a quality product that was fit for a king, or a Senator, or the President of U.S.A. I left my cows today, to represent working dairy farmers across the country who believe Dairy Policy needs to be written by those who get up before daylight to milk the cows. As dairy farmers we have been meeting in different regions around the country for the last three years because our problems have continued to worsen since 1980. We will continue this campaign, and process breaking down the barriers between the different regions because we believe it is time for dairy farmers to unite, and be heard.

On my farm because of my family's continued will to survive, we have increased our milk production from 58 lbs/cow/day to 65 in the last three months. Our milk check however, was less than it was before because of the .50¢ in January. Instead of being able to reward my family for our efforts; it was as if we were spit in the face. We took this .50¢ cut for producing over the 5Billion lb. trigger set in the 1985 Farm Bill. However shortly after this the USDA states that the food assistance programs will no longer be able to recieve cheese, and milk because the "surplus" has been reduced. We wish to call for an oversight hearing to review, and investigate this seeemingly unjustified cut, and it's relationship to the food assistance programs.

Everyone must understand that by reducing the price to the farmer encourages him to increase production to meet the reduced income. II.) What is needed is a fair price set at 75% of parity with supply management to reduce the "surplus", and (by the way) without putting one cow on the beef market. How is this? Gentlemen, there is not a dairy farmer in this country today, that could not through their management practices, reduce their production 5% over a 5 day period. 75% parity price, and a regional base alotment program, dairy farmers (at the farm level), can produce the needed amount of a high quality product, to feed this nation.

III.) Senator Leahy, we support your call for National Dairy Policy that includes regional approach to the correcting the surpluc, and deficit problems. A regional dairy plan will also produce higher quality local product, less expensively. It also insures that dairy farmers will continue to be able to support the local tax base, and local merchants. But, we believe parity pricing, and supply management are the vital key to the long-term success of any fair regional dairy plan.

IV.) We would like to also go on the record as being aware of the $1 million dollar Dairy Commission report called for in the 1985 Farm Bill, having testified before this commission, and having talked with farmers across the country, we don't feel that this report truly represents what working dairy farmers want in national policy. We want a fair price, supply amnagement, and a regional approach.

SINCERELY YOURS

Tom Trantham

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STATEMENT OF TOM TRANTHAM
PRESIDENT UNITED FARMERS ORGANIZATION
ON BEHALF OF

NATIONAL DAIRY CAMPAIGN
NATIONAL SAVE THE FAMILY FARM COALITION

BEFORE THE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
U.S. SENATE

SENATOR PATRICK LEAHY, CHAIR

MAY 11, 1988

Thank you, Mr. Chair for this opportunity to testify before you today. My name is Tom Trantham. I am a dairy farmer from South Carolina and serve as the President of the United Farmers Organization - a farmers organization in both North and South Carolina.

I am here today representing the 46 member National Save the Family Farm Coalition and the National Dairy Campaign. The National Dairy Campaign is a network of family dairy farmers who have been working together to build consensus on dairy policy and resolve the regional differences that tend to divide dairy farmers.

Over the past two years farmers have met and discussed their concerns at national meetings and dozens of regional and local meetings to address dairy policy reforms.

Regionalism is an important element in the dairy policy debate. We should not, however, allow regional differences to distract us from the deeper, common basic problems facing America's family dairy farms.

Dairy farmers are the most geographically diverse commodity producers in America. They operate in every state under every type of condition. Dairy farmers have long been victims of the divide and conquer strategy. Politicians pit farmer against farmer blaming one region for the problems of another. The family farmer from California is not more at fault than the family farmer from the Southeast. We are all only struggling to survive.

The current dairy program is a failure for family farmers across the country because it is destroying the infrastructure of the dairy industry. The 1985 Farm Bill has encouraged regional imbalances. Its price cuts and the herd buy-out have encouraged production in those regions that can produce for less, forcing more farmers off the land in regions where production costs are higher.

The Dairy Farm Protection Act (S. 1869) is an important step in that it provides a framework for regional dairy policy ideas. Some elements of the legislation, its regional decision making and CCC bases and the potential for farmer referendums are positive. But these only scratch the surface of needed reform. As proposed, it would lock in a milk price much too low to provide family farmers any protection, In fact this low price would guarantee the continued loss of family farms.

Under the proposal milk prices would only increase if CCC purchases were kept below 2.5 billion pounds annually. This is unrealistic considering our nations' milk needs. USDA officials say that they will need to purchase 8 billion pounds of milk equivalent to meet government needs. In addition last year the TEFAP program alone used over 5 billion pounds of milk equivalent. This direction in policy hurts both farmers and consumers.

The legislation also continues to rely upon assessments as an incentive to reduce production - a policy that has shown to have no impact on production. This legislation takes a bad national policy and regionalizes it - it does not improve it.

For any dairy policy to work, it must be based on an accurate projection of our nations' total milk demand. At the present time, dairy farmers are being punished for over-production while food assistance programs are being cut because of dairy shortages. USDA figures show CCC NET inventories of cheese and milk powder at zero. Yet, farmers are told to expect yet another price cut due to supposed "surpluses."

We urge this Committee to reform the CCC Dairy program as a necessary first step. The term surplus must be redefined to distinguish between over-production and necessary supplies. Once our milk needs are accurately determined, farmers can adjust production up or down to meet that need.

The National Dairy Campaign offers an alternative - the National Dairy Reform Plan. It will:

1) Maintain adequate dairy supplies nationally
2) Stabilize and increase farm income
3) Balance production with demand

The National Dairy Reform Plan establishes a two tier milk pricing program. Most producers are used to operating under a two tier pricing structure. The program is voluntary. A dairy farmer's production will not be limited. However, the pricing structure will encourage balanced supplies and discourage over-production.

In order to be successful, a two tier program must:

1) set an adequate and stable base milk price
2) set an over-base or surplus price that is low enough to discourage over-production.

The Dairy Reform Plan sets an initial price of 75% of parity for base milk. Over-base milk will be assessed a levy that reduces the actual milk price to 25% of the support price.

Under this plan, the country will be divided into regions.

Each region elects a farmer/consumer Dairy Board and an authorized CCC purchase level for milk will be established for each region. As demand for milk fluctuates, individual production bases will be adjusted for all producers in a region.

In the case of increased demand:

1) Producers in regions that are at or below their CCC base will share equally in increased base.
2) Regions exceeding their CCC base will be ineligible for any new base.

In the case of decreased demand:

1) Regions exceeding their CCC base will be the first required to cut individual bases.
2) If all regions are below CCC base all farm production bases will be cut.

We know how important it is to build consensus on dairy policy. Mr. Chair, we look forward to working with you and the Committee in the months ahead to create a dairy policy that works for both family farm producers and consumers. It must achieve our dual goals of providing an adequate supply of milk for all consumers and a fair and stable price for all dairy producers.

Thank you for your consideration. I will be happy to answer any questions.

The **CHAIRMAN**. Mr. Shupe.

STATEMENT OF HARRY G. SHUPE, COUNSEL, NATIONAL INDEPENDENT DAIRY-FOODS ASSOCIATION, WASHINGTON, DC

Mr. **SHUPE**. Thank you, Mr. Chairman. I am Harry G. Shupe, counsel for the National Independent Dairy-Foods Association [NIDA].

We are a national association of independent handlers, processors, manufacturers and distributors of all varieties of milk and dairy products. We market the milk produced by independent farmers and dairy cooperative.

COMMENTS ON REPORTS

Our members were asked to comment on the three different major reports and concerns here, and first I will talk a little bit about the National Dairy Policy Commission report.

We endorse this market-oriented approach. But we do not think even though there was unanimous endorsement by the 18 commissioners, we think by the time we get to dairy legislation next year there is going to be a lot of dissension. And from what I have heard here this morning it already sounds like it.

The **CHAIRMAN**. If you could read my mail, you would know it is for sure.

Mr. **SHUPE**. We disagree with the conclusions in the report that call for an economic pricing formula. The reason is it is impossible to determine it. It would be rigidly applied. It would be subject to political manipulation, and it would not be based on marketing considerations. It would cause more surplus milk.

PRODUCTION CONTROLS

We are against production controls. We think that any reasonable person that looks at the dairy termination program or the previous dairy diversion program has to come to the conclusion that they did nothing to give a permanent solution to the surplus of milk and the high cost of CCC acquisitions.

We are against this supply management idea which would have quotas, bases, and two-tier pricing. It is very simple. We think it has failed where it has been used. I heard a cost of $750,000 this morning in Canada for a young farmer to go into the business. It enriches the guy who has the base and the quota. It bars new people from going into the business. It locks in the inefficient farmers and it raises costs to consumers.

It would be most unfortunate if Congress decided to mandate either one of these supply management or two-tier pricing programs or any other program for the Secretary to put into effect at a certain trigger level.

MARKET ORDERS

Now getting to the market orders, NIDA has long held the view that these orders serve a purpose: to stabilize marketing conditions. The orders help assure needed supplies of milk at more uniform prices. This is important because the power of regional producer monopoly associations and their federations exceeds the bargaining power of most of the independent handlers and processors.

NIDA QUESTIONS ABOUT GAO'S CONCLUSIONS

But we believe that some examination should be made. Our questions about the GAO report are very simple.

One, will these proposals increase milk supplies, particularly from independent producers, or nonmonopoly cooperatives and nonprice fixing federations?

Two, will these proposals mean that all handlers and processors will have reasonable access to adequate supplies of fresh fluid milk at competitive, uniform prices?

My third question: Will these proposals totally destroy local milk supplies by depressing prices to local producers below break-even points, and if so, who will control distant milk supplies, and what will be the costs to handlers?

The simple problem here is if milk is going to be produced at lowest cost production areas, and it is 2 or 3,000 miles away from my plant, who is going to control that milk, how am I going to get it, and how much is it going to cost me?

And how am I going to compete? Very simple. GAO does not answer that. It would be a phased-in type of thing, and during this period a lot of people might go broke. We believe, though, that Congress will find answers to this, and before it does anything to change the market order system.

BALANCED MARKETPLACE

Now we believe a balanced marketplace, a level playing field for independent proprietary handlers and processors, must come first before we start to wipe out the Federal market order program.

PROPOSED LEGISLATION—S. 1869

Now, finally, in regard to Chairman Leahy's bill, we have doubts about this, and our problem is we think it would create a costly new set of regulations, regional boards and whatever and orders to enforce. This would be expensive and costly. Earlier, we heard testimony here, I think, at the previous hearing about how the California cheese plants would end up taking away the Upper Midwest cheese business and would create an assessment problem for farmers in the Upper Midwest. And this is something, a regional program, we do not want that to happen.

Again, we would have a problem of hiding milk and moving milk and pricing of outlaw milk. We do not think that should be done. We do not like the idea, the proposal in that bill which would give broad authority to the Secretary to put into effect alternative production stabilization programs.

We think the better path for Congress would be to look at the present market order apparatus. What authority does the Secretary now have to effect adequate milk order area supplies of Class I and manufacturing grade milk? What can the Secretary do at this time through the hearing and order procedure to assure adequate supplies at fair and reasonable prices based on local costs of production?

What additional authority does the Secretary need? If Congress decides to go to a regional approach, why doesn't Congress look at what we have already have? We have a regional program and a regional system. We have the Federal market order system. The Agriculture Marketing Act has not been looked at in years and years even though we proposed from time to time amendments that we think would be in the best interest of our members.

I just want to quote one of our NIDA members who said at a recent meeting, the regional problem is this, and he faces it: "If a national program," which we now have, "determines that my local producers are no longer a viable source of milk supplies, and all milk should be produced 2,500 miles away, then my manufacturing plant has no reason for being located at such a distance from the lowest cost of milk production."

This member happened to be from New York. Thank you, Mr. Chairman.

[The prepared statement of Mr. Shupe follows:]

**NATIONAL
INDEPENDENT
DAIRY-FOODS
ASSOCIATION**
SINCE 1957

321 D STREET, N.E., WASHINGTON, DC 20002, (202) 543-3838

STATEMENT OF THE

NATIONAL INDEPENDENT DAIRY-FOODS ASSOCIATION

ON THE REPORT OF THE GENERAL ACCOUNTING OFFICE
ON MILK MARKETING ORDERS;
THE REPORT OF THE NATIONAL COMMISSION ON DAIRY POLICY;
AND A PROPOSAL FOR A REGIONAL DAIRY SUPPORT PROGRAM

BEFORE THE

UNITED STATES SENATE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

May 11, 1988

A merger of National Independent Dairies Association and National Association For Milk Marketing Reform

STATEMENT OF HARRY G. SHUPE, COUNSEL, NATIONAL INDEPENDENT DAIRY-FOODS ASSOCIATION

Mr. Chairman, Members of the Committee, we appreciate this opportunity to express the viewpoint of the National Independent Dairy-Foods Association (NIDA) on the issues raised in these complex reports and the legislation introduced by Chairman Leahy.

NIDA is the national trade association of independent handlers, processors, manufacturers and distributors of all varieties of milk and dairy products. Our members market the milk produced by independent dairy farmers and cooperative associations. NIDA members buy milk and turn it into fluid or manufactured products which are sold in local markets, and also in multistate and national markets.

Our members endorse the "market-oriented" concepts announced in the Commission's report. The unanimous endorsement by all 18 Commissioner-dairy farmers is a hopeful step toward establishing a reasonable national dairy policy. We know that the congressional leaders who deal with agriculture on an annual basis have been looking forward to unity among dairy farmers for several years. Unfortunately, we don't think this report will unify all producers in the long run. NIDA expects that there will be considerable dissention among farmers next year. NIDA does not accept this report as a blueprint for 1990 legislation. Producers will be divided on dairy farm size and regional issues, as well as Class I differentials and support price policy. This will become apparent during hearings next year. The proprietary handlers, processors and manufacturers do not unanimously endorse this report.

NIDA absolutely disagrees with certain major conclusions and recommendations of the Commission as follows:

1. The support price must not be set by a national formula legislated into law. The reasons are clear:

(a) a true national support price formula is likely impossible to determine;
(b) it will be rigidly applied;
(c) it will be subject to political manipulation;
(d) it will not be based on market balancing considerations; and,
(e) will cause new surplus milk problems.

2. Production controls should not be included in new dairy legislation for any purpose at any trigger level. The reasons are obvious if one assesses the results of the Dairy Termination Program and the producer-recommended dairy diversion program. Not only did these programs fail to achieve any permanent results in reducing surplus dairy program costs, they created milk shortages and distorted normal production/distribution patterns in various areas of the country. They were a costly, wasteful experiment. They were costly to dairy farmers and taxpayers.

Supply management with production quotas, bases and two-tier pricing is totally contrary to the "market-oriented" concept. Such a system would cause higher than necessary prices for fluid milk supplies and for consumers. It has been demonstrated that quotas and bases enrich certain producers, bar new entrants and lock in the inefficient farmers. It would be most unfortunate if either a Dairy Termination Program or two-tier pricing program were mandated for the Secretary to order into effect at a certain CCC purchase level.

3. NIDA opposes some of the changes suggested by the National Commission on Dairy Policy in regard to the Milk Marketing Orders. Liberalizing the means of calling hearings, and increasing the possibility of having unjustified, discriminatory and unneeded marketwide service payments are bad proposals. NIDA has long held the view that these orders serve a purpose to stabilize marketing conditions. The orders help assure needed supplies of milk at more uniform prices. This is important because the power of regional producer monopoly associations and their federations exceeds the bargaining power of the independent handlers and processors. This does not mean that no examination should be made of the milk marketing order system, or that no changes are possible.

The General Accounting Office's recommendations present new problems for the industry.

NIDA has these questions about GAO's conclusions:

1. Will these proposals increase milk supplies, particularly from independent producers or non-monopoly cooperatives and non-price fixing federations?

2. Will these proposals mean that all handlers and processors will have reasonable access to adequate supplies of fresh fluid milk at competitive, uniform prices?

3. Will these proposals totally destroy local milk supplies by depressing prices to local producers below break-even points, and if so, who will control distant milk supplies, and what will be the costs to handlers?

4. How will Class II and lower class users be supplied, and at what price levels?

These questions and many more have answers but the GAO Report doesn't supply them. It only poses new questions and problems for the Secretary to monitor during the phasing in of the changes. We have no doubt that Congress will find satisfactory answers before it makes any substantive changes such as these suggested by GAO. NIDA opposes these GAO changes as they have been presented.

A balanced marketplace, a level playing field for independent proprietary handlers and processors, must come first.

Finally, in regard to the proposed legislation for a regional dairy support program, NIDA offers these suggestions:

1. As proposed, it would appear to create a complicated and costly new set of regulations, boards and orders to enforce.

2. Some experts warn that large new production areas, such as California (West Coast) and Texas (Southwest), will manufacture cheese with their surplus milk and sell it commercially, not to CCC. This will reduce sales of cheese produced in the Upper Midwest and result in increased CCC purchases of surplus milk and cheese from the traditional milk-producing areas of Wisconsin and Upper Midwest. The result, after a regional assessment, will be

lower over-all returns for this area, which is one area the legislation seeks to protect.

3. Regional purchase levels and assessments against the regional dairy farmers for exceeding those levels would create massive problems of hiding, moving and pricing of outlaw milk.

4. Giving broad authority to the Secretary to put alternative production stabilization programs into effect would be unwise.

Finally, in regard to other proposed legislation, NIDA believes that food assistance programs should not be combined into or be interdependent upon existing dairy programs and surpluses. They should stand upon their own justification.

The nation's milk reserve supply should be set at levels to assure an adequate supply to all handlers and meet the needs of current Federal usages.

The better path for Congress would seem to be to look at the present market order area apparatus. What authority does the Secretary now have to effect adequate market order area supplies of Class I and manufacturing grade milk? What can the Secretary do at this time, through the hearing and order procedure, to assure adequate supplies at fair and reasonable prices **based on local costs of production?** What additional authority does the Secretary need? If Congress decides that a regional program is the best answer, it should thoroughly examine the market order areas, make the changes which are needed and give the proper directions to the Secretary. In no event should any new market order authority be used to enhance producer monopoly power. These questions Congress must answer before new legislation next year.

The regional problem was simply stated by one NIDA member: "If a national program determines that my local producers are no longer a viable source of milk supplies, and all milk should be produced 2,500 miles away, then my manufacturing plant has no reason for being located at such a distance from the lowest cost of milk production." A reasonable answer should be found for this dilemma.

Senator **Conrad** [presiding]. Thank you very much for your statement. Let me just clarify where we are because we have four remaining witnesses, and the committee is very interested in receiving your testimony. I want to make sure that we accommodate those of you who have come here and have spent time preparing this testimony.

Let me just ask each of the successive witnesses, if you can, to summarize to the best degree your testimony. The complete prepared testimony will be entered into the record, and I am willing to stay beyond 12:30. I have some people that are waiting for me, and they will just have to wait a little longer.

But I want to make sure each of you will have a chance to provide your testimony. Next we will hear from Dr. Ortego. Welcome, and proceed.

STATEMENT OF ALBERT J. ORTEGO, JR., SENIOR VICE PRESIDENT, MARKETING AND PLANNING, DAIRYMEN, INC., LOUISVILLE, KY

Dr. **Ortego.** Thank you, Senator Conrad. We want to first commend the chairman and the rest of the committee for holding this series of hearings. We believe this is a good beginning of the discussions of what should be included and the issues involved in the 1990 farm bill, and we look forward to working with you as you all go on through and try to develop this package.

Let me say that if my prepared statement is going to be filed, I just want to make a few points for the record that are not in my paper.

INTERPRETATION OF THE SOUTHEAST

First of all, I am from the Southeast, and I want to clarify a couple of things. As used in my interpretation of the Southeast, we include Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Virginia. We do not include Texas and Arkansas. That area, normally, we consider the Southwest.

The Southeast was greatly affected by the DTP and the diversion program. It had the biggest participation and the biggest impact on its supplies of milk, and it is an area where 70 percent of the milk on an annual basis is utilized in the fluid market and practically all of the remainder is used in soft products such as cottage cheese, yogurts and so forth.

Less than 4 percent of milk's supply goes into hard products and more than 95 percent of the hard dairy products, cheeses, butter, and so forth, that are consumed in the Southeast come from other areas. So we are highly dependent on other areas in lots of ways. So we are interested in that.

The next point I would like to make is: the Federal order program and the price support program are two programs that can be used together to handle both national and regional problems in the dairy industry, in our opinion. Raw milk, Grade A milk, can be processed into several different products, and it is those products that have different geographic and product markets. It is this fact which creates the need for regulation to attract milk for fluid use from other uses.

Cheese, for example, is one product made from milk, is in a national, if not international market. Fluid milk markets are certainly more interdependent, local markets or regional markets at best. And these do make some differences in how you handle the total programs.

The next point I would like to make is we need to recognize that one of the major objectives of both programs is to stabilize prices. The comment has been made that it has been to enhance prices. These programs were designed to stabilize prices and to prevent some of the wide fluctuations.

When you do stabilize prices, assuming that dairy farmers are risk averters, then you do allow them to have some ease or make investments readily because they will avert some additional risks than without regulation.

That gets into the point of the price discrimination aspect that was discussed earlier under classified pricing and the quote "social costs" of raising prices to consumers. There is a study that shows if we shift the supply function only 2 percent by the improvement in the stability of milk prices, that shift alone will more than offset all of the social costs that have been calculated by any study on classified pricing.

I want to point that out. If we do stabilize prices and farmers avert risks, there are benefits beyond what the social costs are today.

Now, the other thing is the distance differentials. I want to raise two questions which I state quite a bit about in my prepared statement. Alabama is the most deficit milk state percentagewise in the Nation, more than Florida, or more than any other area, more than South Carolina, Tom.

If we have no distance differentials, who is going to supply milk from the Louisville, Kentucky area to Mobile and Montgomery, Alabama? And secondly, if they cannot move that milk to Mobile and pay the cost, is it going to go to the manufacturing plants in Louisville area and be used to produce cheese which will probably go to the Government?

So I think everybody ought to think about this. I do not think it will result in any program where you will not have distance differentials. But I point that out.

The other thing that I would like to add, two issues that I would like to make. One is with respect to reconstitution. Reconstitution and compensatory payments and down allocation. Price discrimination in economic terms requires that three conditions exist.

First, you have to have two or more separate markets to utilize it. Second, those markets have to have significantly different demand elasticities. And third, there has to be no leakage from the low price market to the higher priced market.

The compensatory payments and the down allocation are the best means whereby you can prevent leakage from the low class market to the high price market. With cheese you have no problem. Once cheese is made, you cannot get it back into fluid form. With powder you can.

The act mandates the use of classified pricing, and therefore, some method to prevent leakage must be included in the regulations, and compensatory payments and down allocations are probably the most effective means of doing this.

The other point is with respect to concept of how we are going to control the balance of supply and demand. We believe that price is the best means, long term, to balance supplies with demand, primarily because it is impartial as to individuals. It is impartial as to where milk will be produced. It has no regional implications. It is more efficient than noneconomic restraints, and we cannot put ourselves in this country as to determining the fact that we will not let any regional adjustments in the production of any commodity take place. We have never been successful in that anyway. Thank you.

Senator CONRAD. Thank you very much, Doctor Ortego. We appreciate your testimony.

[The prepared statement of Dairymen, Inc., presented by Dr. Ortego, follows:]

Statement of

DAIRYMEN, INC.

Before the

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

UNITED STATES SENATE

With respect to

United States Dairy Policy

May 11, 1988

Dr. A. J. Ortego, Jr.
Senior Vice President
Marketing/Planning
10140 Linn Station Road
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502/426-6455

TESTIMONY BEFORE
SENATE AGRICULTURE COMMITTEE
MAY 11, 1988

Mr. Chairman, I am Albert J. Ortego, Jr., Senior Vice President, Marketing/Planning of Dairymen, Inc., with corporate offices at 10140 Linn Station Road, Louisville, Kentucky 40223. Dairymen, Inc. is a milk marketing cooperative representing about 5,800 dairy farmers located in 16 states, mainly in the Southeast.

We commend you, Mr. Chairman, and members of the committee for holding this series of hearings. We view them as the beginning of discussions of those provisions which should be included in the 1990 farm bill. The reports of the National Commission on Dairy Policy and the General Accounting Office present a number of recommendations which deserve serious review in the weeks and months to come. We are pleased to have this opportunity to comment briefly on these issues today. We look forward to working closely with the Committee, as it focuses in more detail on specific proposals contained in both reports.

Our primary focus today, however, will be with respect to the Federal Order System and the recommendations contained in the General Accounting Office Report.

NATURE OF MILK PRODUCTION AND MARKETING

While we have seen many changes in the past four decades, the basic economic characteristics of milk production and raw milk marketing are fundamentally the same today as they were in the 1930's, when state and federal governments first implemented programs to stabilize prices and to improve milk marketing conditions. In many ways, dairying is unique!

Milk continues to be a highly perishable product that can be stored, in its original form, for only a very short period. Milk is bulky relative to its value, hence, costly to transport long distances. It is harvested daily which, along with its perishability, requires marketing arrangements to be made in advance of production. Milk production uses highly specialized resources which today have very limited alternative use. Hence, once one has made an investment in dairying, his investment is sunk -- that is, it cannot be shifted readily to other uses. These characteristics indicate that in the short run supply is very price inelastic. That is, the total supply is not quickly sensitive to price changes.

The demand for milk and dairy products is also highly inelastic in the short run. That is, changes in price do not result in corresponding proportional changes in sales. Further, the structure of the dairy industry is highly concentrated at the processor and the retail level, but remains highly competitive at the farm level, particularly in the Southeast. In addition, milk production varies greatly from spring to fall.

These characteristics of the product, its market, and the concentration in the industry are conducive to highly variable market prices that generally result in cyclical patterns of production. The regulatory price programs were designed to overcome these undesirable characteristics of dairying and to reduce the market risk for milk producers resulting from highly unstable prices. As an adjunct to these benefits to farmers, consumers also benefit from the lower average price that is associated with reduced risk to farmers, under the assumption that farmers do avert risk, if possible.

Because conditions which contribute to price instability and cyclical production patterns continue to exist in the dairy industry, the need for government regulations exists as much today as when they were first enacted by Congress.

Further, milk is a basic product that can be processed into numerous products for further processing. For example, milk can be sold to consumers in fluid form, or transformed into products such as ice cream, cottage cheese, yogurt, butter, cheeses, and non-fat dry milk. Once transformed, these products are marketed in entirely different geographic markets. More importantly, fluid milk competes in interdependent local, and at best, regional markets; whereas, hard cheeses, butter and non-fat dry milk compete in at least national if not international markets. It is these different product forms that were and are important to the Federal milk marketing orders and they are the ones that give rise to regional differences and problems when uniform, non-economic restraints become part of national policies. It is important, when developing new legislation, that you give consideration to the basic characteristics of milk production, the inelasticities of its supply and demand, and the different markets that exist for the various products made from raw milk.

With this background in mind, the remainder of our views will be divided into three parts: (1) Description of the Southeast, (2) the Price Support Program, and (3) the Federal Order Program. Comments on the Southeast and the Price Support Program will necessarily be brief so that we may devote a few more comments to the Federal Order Program and the General Accounting Office Report.

I. THE SOUTHEAST MARKET SITUATION

The situation in the Southeast [1] differs considerably from that in other areas. These differences greatly influence the impact of various policies on the market in that area. Likewise, these market differences greatly influence the positions taken on alternative programs.

Population growth in this area is projected to be above the national average. Projections by the Bureau of the Census are that population in the South will increase about 16 percent between 1980 and 1990, and another 13 percent by the year 2000. Much of the growth projected for the South will occur in the Southeast, particularly in Florida, South Carolina, Georgia, North Carolina and Tennessee. In addition, disposable incomes in the area are also expected to increase more rapidly than the national average.

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[1] Southeast, as used herein, includes the states of Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Virginia. (Table 1)

TABLE 1

Milk Production in the Southeast As Percent Of The United States Selected Years

	1967	1972	1977	1982	1987
Alabama	812	820	684	580	502
Florida	1,576	1,867	1,993	2,109	2,209
Georgia	1,030	1,235	1,301	1,412	1,155
Kentucky	2,550	2,530	2,426	2,364	2,338
Louisiana	1,032	1,132	1,089	975	877
Mississippi	1,114	993	858	900	786
No. Carolina	1,488	1,537	1,583	1,686	1,555
So. Carolina	521	518	525	567	547
Tennessee	2,144	2,147	2,181	2,326	2,207
Virginia	1,780	1,760	1,894	2,059	2,016
Total S.E.	14,047	14,539	14,534	14,978	14,192
% of U.S.	11.83	12.13	11.85	11.03	9.96
Total U.S.	118,732	119,904	122,654	135,802	142,462

Population growth, higher disposable income, and declining real prices for milk will enhance the effective demand of consumers for milk for fluid use, as well as for all dairy products. Hence, more milk will be needed to meet the fluid milk demand of the region in the future.

Milk produced in the Southeast is used primarily for Class I use. On an annual basis, more than 70 percent of the milk produced in the Southeast is used for fluid consumption. Much of the remainder is used to produce such products as cottage cheese, ice cream, sour cream, dips, yogurt, and other such products. Only a small part of the total production goes to manufacture hard cheeses, butter and non-fat dry milk.

The Southeast is generally referred to as a deficit milk producing area. Milk, in both bulk and packaged form, is brought into the area on a regular basis. During 1986, more than 4 percent of the fluid milk sold within the Southeast was brought in from other areas. This varied from a low of about 2.5 percent during April to slightly more than 10 percent during October.

The price of a product rises until the supply is adequate to meet the demand at that price. An efficient pricing system will attract the necessary supply from the least cost source. Hence, the necessary supply will be either produced locally or in more distant areas, or both. Price in a deficit area, if unfettered, will rise to the cost of the marginal supply. Hence, the price in any area will be less than, or at most equal to the price of its alternative supply. This economic principle has been very important to pricing under the Federal Order System.

Given that fluid milk markets are local or regional and that the Southeast does not (on a year-round basis) produce adequate milk for its fluid needs, then programs to restrict national production, by means other than price, create serious market distortions (and problems) for the area and any similar region.

The Southeast has experienced these market distortions and the accompanying problems twice in the last four years. First was during the Diversion Program when the Southeast producers participated in that program at a rate greater than the average for the nation. The second was the result of the Southeast's greater than average participation in the Dairy Termination Program.

During both of these periods, higher than normal amounts of milk had to be brought into the area to meet the needs for Class I milk. Such importation is expensive. The cost of this supplemental milk has been borne by those producer groups or processors who actually imported the milk. The inability to raise all prices to the level of the cost of the marginal supply created serious inequities among producers and/or processors, depending on who purchased the supplemental milk supplies.

II. THE PRICE SUPPORT PROGRAM

Dairymen, Inc. strongly supports the continuation of a price support program for milk and dairy products. The price support program for milk and dairy products is the only commodity price support program that has been in effect continuously since 1949, and which has had no mandatory restrictions on output. Other than the 1984 Dairy Diversion Program and the recent Dairy Termination Program, adjustments to keep supply and demand in balance have depended directly upon price and, to a lesser degree, on Section 22, Import Quotas.

Over the last four decades, the price support program has worked unusually well, in our opinion. Only twice during this lengthy period did production exceed commercial use to the extent that burdensome surpluses prevailed for a significant period. The first was in the early 1960's and the other is the recent and present one.

The stated purpose of the dairy price support program is to provide an adequate supply of milk and dairy products for the domestic market and to maintain the productive capacity in dairying at a level that will assure an adequate future supply. The key issue now is: What mechanism will be used to achieve the objective -- Price? or supply management? or both? Let us pass up the historical review and look at the current situation.

We all know that farmers responded to the 80 percent of parity price support level and the semi-annual adjustments initiated in 1977. During the period from October 1977 to October 1980, the support price rose from $9.00 to $13.00 per hundredweight -- an increase of 46 percent. And, farmers have continued to respond to improvement in milk productivity, to depresssed prices for feed and to low returns from other farm enterprises. The combination of low feed prices, few good alternative uses of farm resources, and few off-farm employment opportunities have helped to maintain resources in dairying and have, to a degree, attracted additional resources in some areas of the country.

Today, nationwide, we have about the same relationship between the price of feed and the price of milk as we had in 1980 (see Tables 2 and 3). We project that feed prices will begin to gradually strengthen. Therefore, we think it is premature to conclude that the Food Security Act of 1985 does not have adjustment provisions sufficient to bring supply and demand into balance. While we strongly support the Price Support Program, there are a number of ways in which we believe the program can be improved.

When a new program is initiated, it should begin at a price level at which there is an acceptable balance between production and commercial sales. Hopefully, that price will be established by the time the present legislation ends. We support the recommendation of the National Commission that a specific dairy price mover should replace the archaic parity concept. Section 22, Import Quotas, should be continued and strengthened. The significant increase in imports of casein for food use continues to contribute to the cost of the Price Support Program. Also, we urge the USDA to maintain strong involvement in international trade negotiations to prevent the dumping of world dairy surpluses on U.S. markets, and to open more foreign markets to agricultural products of this country.

TABLE 2

MILK-FEED PRICE RATIO
UNITED STATES
SELECTED YEARS

	MILK PRICE $ CWT.	DAIRY RATION * $ TON	MILK-FEED RATIO
1975	8.78	135	1.30
1980	13.10	177	1.48
1981	13.80	192	1.44
1982	13.60	177	1.54
1983	13.60	188	1.45
1984	13.50	191	1.41
1985	12.70	168	1.51
1986	12.50	160	1.56
1987	12.50	154	1.62

* 16% Protein ration

SOURCE: AGRICULTURAL PRICES, USDA, WASHINGTON, D.C.
SELECTED ISSUES

TABLE 3

MILK-FEED PRICE RATIO *
UNITED STATES
JANUARY 1984 TO DATE

	1984	1985	1986	1987	1988
JANUARY	1.33	1.57	1.48	1.74	1.51
FEBRUARY	1.33	1.57	1.50	1.69	1.48
MARCH	1.34	1.55	1.48	1.63	1.45
APRIL	1.32	1.51	1.48	1.62	
MAY	1.32	1.47	1.46	1.58	
JUNE	1.32	1.45	1.45	1.55	
JULY	1.35	1.44	1.51	1.56	
AUGUST	1.40	1.47	1.55	1.60	
SEPTEMBER	1.48	1.51	1.61	1.65	
OCTOBER	1.56	1.56	1.75	1.65	
NOVEMBER	1.62	1.55	1.77	1.65	
DECEMBER	1.59	1.53	1.77	1.63	
AVERAGE	1.41	1.52	1.57	1.63	

*16% Protein ration

SOURCE: AGRICULTURAL PRICES, USDA, WASHINGTON, D.C.
SELECTED ISSUES

III. MARKETING ORDER PROGRAM

The Marketing Order Program was designed to assure an adequate supply of pure and wholesome milk for fluid use. In practical terms, this means a set of rules, regulations and prices that will attract milk for fluid use from the local area or distant areas in an orderly and consistent manner.

A major distinction between the Federal Order Program and the Price Support Program needs to be made. The Federal Order Program is designed to attract milk for fluid use, whereas the Price Support Program has the objective of obtaining an adequate milk supply for all uses. Our legislators of the 1930's, in their wisdom, saw fit to have two separate programs for milk. They recognized the differences in the fluid milk and the manufactured dairy products markets.

They recognized that it is expensive to move milk in fluid form and that prices need to be related geographically in such a manner that milk can be drawn from surplus areas to deficit areas for consumption in fluid form, when necessary. Further, these legislators recognized that because the raw product, Grade A milk, can be utilized to produce many products and that a necessary reserve is required to adequately supply the fluid milk market, a system of classified pricing was needed to maintain stable prices and to effectively attract milk from other uses for the fluid market. As a result, the Agricultural Marketing Agreement Act of 1937 requires the use of classified pricing. Classified pricing is a mandatory provision of Federal milk marketing orders. It is the basic pricing procedure that allows milk needed for fluid use to be priced at a price high enough to attract milk for Class I use, and at the same time allow the necessary market reserve and the seasonal surpluses to be channelled into other uses without dismantling the Class I price structure. It is the Class I differentials, as a part of Class I pricing, that has made Federal marketing an effective tool for orderly marketing in fluid milk markets for four decades.

The GAO assertion that the "economic incentive provided by milk marketing orders through Class I differentials, has contributed to recent increases in production" overlooks a number of significant factors. First, Class I differentials had not been increased since the mid-60's until adjustments were mandated by Congress in the Food Security Act of 1985. Class I prices, under Federal Orders, move in concert with the movements in the Minnesota-Wisconsin series price. The Minnesota-Wisconsin series price is directly tied to the level of price supports. Hence, changes in the level of Class I prices in Federal Orders are determined almost entirely by the level of the Minnesota-Wisconsin series price.

Earlier, we made a distinction of different product and geographic markets for fluid milk and manufactured dairy products. The Price Support Program sets a price adequate to generate milk for all uses. The Federal Order System is to attract milk from other uses and to geographic locations for use in fluid form. The Price Support System is one that establishes the basic price levels. The Federal Order System can be utilized to ameliorate regional problems where the economics are such that higher prices are necessary in order to attract milk for fluid use. The price at a deficit location must be sufficiently higher than in a surplus location in order to pay for moving milk from the surplus area to the deficit area. Hence, regardless of the GAO's suggestion that we eliminate division differentials, market forces would certainly result in price differences by geographic area. The basic contribution of the Federal Order System is to establish these differences in a manner that will result in more orderly marketing.

The purpose of the Class I differential is to attract milk, from any source, for fluid use. If supply from local producers is less than the price in other areas plus the transfer cost between the areas, then the supply will be and should be the local supply. The Class I differential was never intended to make it profitable to move milk from any area to another.

Yet, in the Federal Order System, price is not the only provision that affects the availability of milk for fluid use. Classified pricing requires the pooling of revenues from different class prices and then allocating these monies among producers providing the Grade A milk. The qualification of milk for pool participation is a very important provision of a Federal Order for milk. Some orders have pooling provisions that are so liberal that little incentive exists to deliver milk for fluid use. Hence, over-order prices are paid to have manufacturing plants give up milk for Class I use. Requiring that minimum quantities of milk be delivered in order for it to share in the high Class I value would do much to attract milk for fluid use at a lower price.

Elimination of the distance differential would establish the same price at all locations. A uniform Class I price would eliminate all incentives to move milk from production areas to metropolitan areas or the areas where production is less than the demand at that price.

Class I differentials vary from the Midwest outward at an average rate of about 20¢ per cwt. per one hundred miles. Our costs show that it requires 36¢ per cwt. per hundred miles to move milk. Hence, the so called distance differential is only about 56 percent of the cost of moving milk. Hence, milk from local sources is the most economical supply. The Federal Order prices in the Southeast are not generating an adequate supply for fluid use. Eliminating distance differentials would certainly be damaging to the availability of fluid milk in the Southeast.

Since all distance differentials are based from Wisconsin, the question of multiple basing points logically follow for a nation as large as ours. Thus, a thorough evaluation of multiple basing points should be made. The justification for multiple basing points must be predicated on solid foundation of spatial economics. If multiple basing points are determined to be realistic, then such pricing under Federal Orders should be put into effect gradually over a several year period. To do so all at once would be very disruptive to our present marketing system.

The GAO Report raises the issue of compensatory payments and down allocation of milk ingredients when used in Class I products. This issue is more complex and deserves more time than we have available today. Yet, several points should be made. First, the Agricultural Marketing Agreement Act (AMA) of 1937 requires that classified pricing be used in all orders pertaining to milk. Classified pricing, to economists, is a form of what is referred to as price discrimination. For such a pricing technique to be effective, three requirements must be met: (1) there must be two or more distinct or separate markets for the product; (2) the elasticities of demand in each separate market must be significantly different; and, (3) there must not be leakage from the low priced market to the higher priced market. If classified pricing is to provide the stability, then some means must be found to prevent such leakage. There is no problem with cheese. Once milk is processed into cheese, that milk (cheese) cannot be returned (leaked) to a fluid use. However, milk in the form of powder can be returned by reconstitution to a fluid Class I use. If there are no compensatory payments, then that handler, which pays the full Class I price as required by the Order, is placed at a disadvantage to one that pays a lower price for powdered milk. Hence, the regulations use compensatory payments to effectively administer the required classified pricing. Down allocation has the same result in a plant where there is Class II and Class III use. In addition, the issue of reconstitution is given more importance than it economically deserves. In the Southeast there are no Federal Orders operating in North Carolina, South Carolina, and much of Virginia. No compensatory payments are required on reconstituted milk in these areas. Even with the high Class I prices in these areas, there is almost no reconstitution taking place. Several years ago, a plant in North Carolina specialized in the production and marketing of reconstituted milk. After several years of intensive marketing efforts, the plant discontinued its milk operation and is now processing only reconstituted orange juice.

The GAO Report suggests an option of marketwide service payments in Federal Orders. The Food Security Act of 1985 specifically authorizes marketwide service payments. The increase in Class I differentials was intended to be used, in part, to offset the cost of marketwide services. Marketwide service payments could partially offset the cost of increasing the Class I utilization of milk in certain Federal Order pools. If the higher revenues from providing milk for Class I use must be pooled and shared with all pool participants, then the cost of obtaining and making such Class I sales should also be shared. We, at Dairymen, Inc., have strong convictions in support for marketwide service payments.

Federal Orders are needed in the Southeast. They have been and continue to be beneficial to producers, processors and consumers. Orders need to be tailored to the market conditions existing in the area to which they apply. In a nation as large as the United States, a nationwide order would not adequately reflect market conditions in any area.

We believe that Marketing Orders should be used to serve the need of the fluid markets. In conjunction with the Price Support Program, the Order System can operate more effectively and better reflect the economics and market conditions which vary from one area to another. A nationwide order could not adequately do this.

CONCLUSIONS

We, at Dairymen, Inc. believe the present legislation is working and should be allowed to run its course. Afterward, the Price Support Program should be continued with modifications such as a dairy specific price mover, and a strengthened Section 22. Price should be used as the major factor to balance supply and demand, particularly in the long run. Restrictions on production or supply management programs tend to increase production cost, prevent economic shifts in production among regions, and fail to recognize changes in the location of demand for fluid milk and dairy products.

The Federal Order Program, although it can be improved, continues to serve the needs of the fluid milk markets. Hopefully, in the future, these orders will be tailored more to reflect the economic and market conditions in the fluid milk markets around the nation.

We thank you for the opportunity to present our views on these important matters.

Senator CONRAD. Next we will hear from George Hildre, the group vice president of Land O'Lakes.

STATEMENT OF GEORGE W. HILDRE, GROUP VICE PRESIDENT FOR DAIRY, LAND O'LAKES, INC., ARDEN HILLS, MN

Mr. HILDRE. Thank you, Senator Conrad. I represent a farmer cooperative, principally with membership base in the Upper Midwest.

My purpose in appearing here today is to specifically oppose the regionalization impacts of the Dairy Farm Protection Act [S. 1869].

I will summarize my points, and leave the support of those points to the prepared written testimony that has already been provided.

Senator CONRAD. I appreciate that very much. There is one other observation I would make. I have had a chance to review your written testimony, and you make the observation: "there are no good guys or bad guys in dairy." I want to emphasize to you that we in North Dakota like to think that the North Dakota dairy farmers are all good guys.

Mr. HILDRE. All good guys. And I will comment on that.

Senator CONRAD. You would accept that amendment, would you not?

Mr. HILDRE. I would accept that comment, yes, sir.

Senator CONRAD. Friendly amendment.

Mr. HILDRE. Point number one, the Dairy Farm Protection Act would actually undermine the effectiveness of the dairy price support program. It would provide different pricing levels for different regions of the country, and since the price support program was intended to be a nationally based program, it would essentially do away with the national base of a price support program.

Point number two, the Dairy Farm Protection Act addresses the symptoms of the excess supply problems, but not the problem itself. Supply excesses are due to either underconsumption, excess production, or price, and the regionalization of those impacts are not actually going to change the national surplus or national deficits.

Third, the Dairy Farm Protection Act undermines the efficiency in the dairy market. It will cause products to not move to the areas of greatest return. An example, Land O'Lakes is a national marketer, and it moves products from the Midwest and from other locations to the consuming public in many areas, including the Northeast.

If in the Midwest there was a regional limitation as to the product that could be sold to the CCC, whether that comes from Land O'Lakes producers or not, the assessment, or the limitation would be placed on Land O'Lakes. The way to avoid that would be to discount our prices, for example, into the Northeast, and we would merely undermine the existing product prices that exist for New York producers and Vermont producers.

And we do not think that is an effective way to handle that particular issue. Lastly, as you said, the Dairy Farm Protection Act is simply unfair, and I would like to make this statement. There is no equitable method to sort out the good guys and the bad guys with respect to the national dairy surplus.

Individual States within a region show markedly different patterns in both milk production and sales to CCC. However the problem is defined, some States that do not contribute to the problem will be lumped in with States that do contribute to it.

We suggest that Congress accept the economic reality of a national market for milk and dairy products, and that they maintain a dairy price support program that promotes efficiency and fair play for all dairy farmers and for the marketing system.

As a final quick summary, I would just like to state that the price support program is a national program and should remain so. It has provided a basic pricing mechanism within the United States for a number of years.

The Federal market orders, although my testimony does not focus on the Federal market orders, have the ability to accommodate regional differences and regional needs, and although the Federal market orders perhaps need some refinement, we feel they are still essential to distributing the price results of the marketplace to farmers.

And we would hate to see an overreaction to some of the concerns that are being raised today. Thank you, Senator.

Senator CONRAD. All right. Thank you very much, Mr. Hildre.

[The prepared statement of Mr. Hildre follows:]

TESTIMONY OF GEORGE W. HILDRE
LAND O'LAKES, INC.
BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION, & FORESTRY

May 11, 1988

MY NAME IS GEORGE HILDRE. I AM GROUP VICE PRESIDENT FOR DAIRY AT LAND O'LAKES, INC. LAND O'LAKES IS A DAIRY AND FARM SUPPLY COOPERATIVE WITH A MEMBERSHIP BASE IN THE UPPER MIDWEST. WE MARKET MILK AND DAIRY PRODUCTS FOR 4,800 DAIRY FARMERS AND 35 DAIRY COOPERATIVES. OUR DAIRY PRODUCTS ARE SOLD THROUGHOUT THE UNITED STATES.

MY PURPOSE IN APPEARING BEFORE THE SENATE AGRICULTURE COMMITTEE IS TO OPPOSE THE PASSAGE OF THE DAIRY FARM PROTECTION ACT. THE FOLLOWING ARGUMENTS ARE OFFERED IN OPPOSITION TO THE BILL:

1. THE DAIRY FARM PROTECTION ACT WOULD UNDERMINE THE EFFECTIVENESS OF THE DAIRY PRICE SUPPORT PROGRAM.

   IF SALES TO THE COMMODITY CREDIT CORPORATION WERE STOPPED OR DETERRED BY THE DAIRY FARM PROTECTION ACT OR SOME OTHER IMPEDIMENT, SELLERS WOULD OFFER THEIR PRODUCTS TO COMMERCIAL CUSTOMERS AT PRICES LOWER THAN THOSE SET UNDER THE DAIRY PRICE SUPPORT PROGRAM. THE LOWER VALUES FOR PRODUCTS WOULD BE TRANSLATED INTO REDUCED PAY PRICE TO DAIRY FARMERS THROUGHOUT THE UNITED STATES. FARMERS IN SURPLUS REGIONS WOULD ACCEPT LOWER PRICES SO LONG AS THEY WERE LESS BURDENSOME THAN PUNITIVE ASSESSMENTS. THE NET RESULT WOULD BE THAT ALL DAIRY FARMERS WOULD EXPERIENCE PRICES THAT WERE LOWER THAN WOULD OTHERWISE BE FEASIBLE UNDER THE DAIRY PRICE SUPPORT PROGRAM.

   ALSO, BY PROTECTING MILK PRICES IN HIGH PRODUCTION-COST REGIONS, THE DAIRY FARM PROTECTION ACT WILL ENCOURAGE GREATER PRODUCTION IN THOSE AREAS THAN WOULD OCCUR WITHOUT THE ACT. THIS GREATER PRODUCTION ADDS TO THE NATIONAL SURPLUS. HOWEVER, THIS CONTRIBUTION TO THE SURPLUS WILL NOT APPEAR AS LOCAL SALES TO CCC, BUT WILL DISPLACE PRODUCTS FROM OTHER, LOWER COST REGIONS, THAT IN TURN WILL BE SOLD TO CCC. THE PUNITIVE ASSESSMENT WOULD NOT BE LEVIED IN THE REGION CREATING THE EXTRA PRODUCTION, SO THERE WOULD BE NO DETERRENCE TO FURTHER INCREASES IN PRODUCTION.

2. THE DAIRY FARM PROTECTION ACT ADDRESSES THE SYMPTOMS OF THE EXCESS SUPPLY PROBLEMS, BUT NOT THE PROBLEM ITSELF.

   THE DAIRY PROBLEM IN THE UNITED STATES IS GREATER MILK PRODUCTION THAN IS ACCEPTED BY CONSUMERS AT PREVAILING PRICES. PRODUCTION, CONSUMPTION, AND PRICES ARE THE THREE ASPECTS OF THE PROBLEM WHICH ARE EXHIBITED AS SALES OF MANUFACTURED DAIRY PRODUCTS TO THE CCC. SOLUTIONS TO THE PROBLEM ARE FOUND IN DISCOURAGING PRODUCTION AND ENCOURAGING CONSUMPTION, BOTH OF WHICH WE SUPPORT; OR BY REDUCING PRICES, WHICH IS THE CURRENT THRUST OF DAIRY POLICY. BY FOCUSING ON SALES TO CCC, THE DAIRY FARM PROTECTION ACT COULD RESULT IN ONE REGION PAYING THE PENALTY FOR AN INCREASE IN PRODUCTION IN ANOTHER REGION.

   FOR EXAMPLE, IF DAIRY FARMERS IN FLORIDA INCREASE MILK PRODUCTION, THEN LESS MILK WILL BE SHIPPED OUT OF THE MIDWEST TO SATISFY FLUID MILK NEEDS IN THAT STATE. THE DISPLACED MILK WILL BE PROCESSED INTO CHEESE OR BUTTER, WHICH MOST LIKELY WILL BE SOLD TO THE CCC. UNDER THE DAIRY FARM PROTECTION ACT, THE MIDWEST WOULD BE PENALIZED.

SIMILARLY, IF EXTRA MILK PRODUCTION IN VERMONT IS PROCESSED INTO CHEESE, IT CAN EASILY DISPLACE MIDWESTERN CHEESE IN BOSTON OR NEW YORK BECAUSE OF LOWER TRANSPORTATION COSTS. THE DISPLACED MIDWESTERN CHEESE WOULD AGAIN BE SOLD TO CCC, LEADING TO INCREASED PENALTIES FOR MIDWEST DAIRY FARMERS UNDER THE ACT.

3. THE DAIRY FARM PROTECTION ACT UNDERMINES EFFICIENCY IN THE DAIRY MARKET.

THE MARKET FOR MILK AND DAIRY PRODUCTS IS NATIONAL IN SCOPE. A POUND OF CHEESE OR BUTTER PRODUCED IN ANY REGION OF THE UNITED STATES CAN BE SOLD IN ANY OTHER REGION. SIMILARLY, FLUID DEMAND IN ANY REGION CAN BE SATISFIED BY GRADE A MILK ORIGINATING FROM ANY OTHER REGION.

MARKET EFFICIENCY, AND THE CONSUMING PUBLIC, ARE BEST SERVED WHEN PRODUCTS ARE DELIVERED TO LOCAL MARKETS AT THE LOWEST COST, INCLUDING PRODUCTION, PROCESSING, AND TRANSPORTATION COSTS. HIGH PRODUCTION-COST REGIONS WILL NOT PRODUCE ENOUGH DAIRY PRODUCTS TO SATISFY LOCAL DEMAND. LOW PRODUCTION-COST REGIONS WILL SUPPLY ENOUGH DAIRY PRODUCTS TO SATISFY LOCAL DEMAND AND FILL CONSUMPTION DEFICITS IN OTHER REGIONS. IT IS ALSO THESE LOW PRODUCTION-COST REGIONS THAT SERVE AS THE BALANCE WHEEL FOR THE ENTIRE DAIRY MARKET, AND SELL MOST OF THE NATIONAL SURPLUS TO CCC. BECAUSE OF THIS, THE DAIRY FARM PROTECTION ACT WOULD PUNISH DAIRY FARMERS IN LOW PRODUCTION-COST REGIONS AND FAVOR FARMERS IN HIGH PRODUCTION-COST REGIONS, REDUCING THE LEVEL OF EFFICIENCY IN THE NATIONAL MILK MARKET.

4. THE DAIRY FARM PROTECTION ACT IS SIMPLY UNFAIR.

THERE IS NO EQUITABLE METHOD TO SORT OUT THE "GOOD GUYS" AND THE "BAD GUYS" WITH RESPECT TO THE NATIONAL DAIRY SURPLUS. INDIVIDUAL STATES WITHIN A REGION SHOW MARKEDLY DIFFERENT PATTERNS IN BOTH MILK PRODUCTION AND IN SALES TO CCC. HOWEVER THE PROBLEM IS DEFINED, SOME STATES THAT DO NOT CONTRIBUTE TO THE PROBLEM WILL BE LUMPED IN WITH STATES THAT DO CONTRIBUTE TO IT.

ALSO, WITHIN A STATE OR REGION THERE ARE DAIRY FARMERS WHO RESPOND DIFFERENTLY TO THE ECONOMIC ENVIRONMENT. UNDER THE DAIRY FARM PROTECTION ACT ALL DAIRY FARMERS WITHIN A REGION WILL BE PUNISHED OR REWARDED THE SAME.

WE RECOMMEND THAT CONGRESS ACCEPT THE ECONOMIC REALITY OF A NATIONAL MARKET FOR MILK AND DAIRY PRODUCTS, AND THAT THEY MAINTAIN A DAIRY PRICE SUPPORT PROGRAM THAT PROMOTES EFFICIENCY AND FAIR PLAY FOR ALL DAIRY FARMERS, AND FOR THE MARKETING SYSTEM.

IF THE REAL AGENDA BEHIND THE DAIRY FARM PROTECTION ACT IS TO AVOID FURTHER SUPPORT PRICE CUTS, WITHOUT ADDING TO THE SURPLUS, THEN CONGRESS SHOULD INSIST THAT THE SECRETARY OF AGRICULTURE INITIATE ANOTHER DAIRY TERMINATION PROGRAM TO REDUCE SURPLUS MILK SUPPLIES BELOW THE FIVE BILLION POUND TRIGGER LEVEL.

I APPRECIATE THE OPPORTUNITY TO EXPRESS MY VIEWS BEFORE THE COMMITTEE.

Senator CONRAD. Next we will hear from Cheryl Cook, legislative assistant of the National Farmers Union in Washington. Cheryl.

STATEMENT OF CHERYL COOK, LEGISLATIVE ASSISTANT, NATIONAL FARMERS UNION, WASHINGTON, DC

Ms. COOK. Thank you, Senator Conrad. I am here today, not just for the National Farmers Union, but also for the Farmers Union Milk Marketing Cooperative which is the third largest dairy co-op in the United States.

Briefly, I would say that we agree with the GAO report's historical analysis of how we got into milk marketing orders. We agree with their assessment of what the current problems in milk marketing orders are. That, in effect, we do have a regional program now that discriminates against the Upper Midwest with distance differentials that allows California programs to come in on their own.

We agree that there are some problems and certainly milk marketing orders could stand to be brought up to date to current marketing conditions. We are very concerned, though, about GAO's proposed solution. We think it defies their own analysis. It very plainly hurts the efficiency of milk marketing in this country.

It would very plainly reduce producer receipts. GAO claims that supplies would come down. With a decrease in price, I think reality has shown us exactly the opposite. At least in the short term, supplies increase when the price goes down.

GAO claims that consumer prices would come down with the price paid to the farmer. I think reality has shown us that the opposite is true there as well. The Economic Research Service issued a report last month that showed dairy prices paid by consumers went up 2.5 percent in the country last year, even as prices to dairy farmers went down.

We see no objective to the GAO recommendation other than putting more dairy farmers out of business and furthering some agenda of getting the Government out of agriculture. We find those very disturbing.

Farmers Union would continue its support of a supply management program. We believe that management of our abundance in this country is neither unreasonable nor irrational, but has, in fact, been the foundation of farm programs and is the only hope of a future for many rural communities.

Let me jump quickly to S. 1869 and say that the major strength, from our perspective, of this bill is that it unashamedly states as its purpose keeping farmers in business. We think in these days of market orientation that that is an important piece of the debate, and we would commend Chairman Leahy for having the courage to introduce a bill like that.

We do have concerns with the bill. For starters, it does not increase price. Chances of a passage of this bill for this year are slim. Chances of Secretary Lyng using a diversion program to avoid the next price cutter are slimmer.

If this bill were to pass next year, we would be at a support price of $10.10. That is not good enough. We are very pleased to see that the bill does include producer input into what kind of a program we are going to have. If Chairman Leahy were still here I would make that recommendation to him. Sometime in early 1989, let us have a referendum. Let us find out what the industry can live with because no program will work if the industry does not support it.

We would be pleased to support the Dairy Farm Protection Act, if we can add some of those things into it, and we would be happy to work with the committee in making that a reality, and thank you for sticking around long enough to give me a chance to get my two cents in.

Senator CONRAD. Thank you. Your testimony was excellent, and we very much appreciate all of the witnesses taking time to be here and to provide your input. Believe me this does make a difference.

If you ever wonder, and I know we have one additional witness, and we will hear from him. If you ever wonder if it does make a difference, I just want to assure you as one Senator that it does. I pay very close attention and read the testimony of witnesses who appear here, especially in those areas where I do not have a strong background. And this is one.

I have a strong background in wheat and feed grains and the cattle markets, but dairy, although it is certainly an element in my State, is not something that I have ever been directly involved in. And so it makes a difference to have people with your background and expertise come and do the work of providing testimony. It affects not only my own view, but it helps my staff as well.

[The prepared statement of Ms. Cook follows:]

NATIONAL
FARMERS
UNION

SUMMARY

STATEMENT
OF
NATIONAL FARMERS UNION
AND
FARMERS UNION MILK MARKETING COOPERATIVE

TO

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE

REGARDING

DAIRY POLICY

MAY 11, 1988

The National Farmers Union believes:

1. The report of the General Accounting Office on milk marketing orders provides a thorough analysis of the current shortcomings in the milk marketing order system.

2. The Agricultural Marketing Act of 1937 and the Agricultural Act of 1949 clearly show a dual purpose for federal dairy policy: maintenance of an adequate supply of pure and wholesome milk for consumers, and support of farm income at a level adequate to maintain productive capacity.

3. GAO's recommended option of removing the pricing function of milk marketing orders, with eventual elimination of orders does not meet established legislative goals. By GAO's own analysis, such a course of action would disrupt market orderliness and decrease farm income.

4. A national supply management program is needed to address a national problem of overproduction. Such an option would be more in line with traditional policy goals.

5. It is impossible to fault any particular region of the country for dairy product surpluses.

6. S. 1869, the Dairy Farm Protection Act, is a valuable addition to the policy debate, because it reaffirms that keeping farmers in business is a legitimate federal goal.

600 Maryland Avenue, S.W. • Suite 202 • Washington, D.C. 20024 • Phone (202) 554-1600

NATIONAL
FARMERS
UNION

STATEMENT
OF
NATIONAL FARMERS UNION
AND
FARMERS UNION MILK MARKETING COOPERATIVE

TO

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE

REGARDING

DAIRY POLICY

MAY 11, 1988

Thank you, Mr. Chairman, and good morning. I am Cheryl Cook of the National Farmers Union. I'd like to start by passing on the regrets of our President, Leland Swenson, who could not be here today due to a prior commitment with the International Federation of Agricultural Producers in Australia. I am also testifying this morning on behalf of the Farmers Union Milk Marketing Cooperative, which is the third largest dairy cooperative in the United States.

Our policy positions on dairy issues and marketing orders generally, which were adopted by our member delegates at our annual meeting in March, are included with my statement. I would like to address both the report of the General Accounting Office (GAO) on Milk Marketing Orders and S. 1869.

As is probably the case with every group on every proposal, there are elements of the GAO report and the bill with which we strongly agree, and others with which we cannot agree. The National Farmers Union's Dairy Council, made up of eleven dairy farmers from ten different states, reviewed the report and the bill in depth at its meeting last week. The group reached several conclusions in light of our policy statement, which I would like to pass on to you this morning.

The GAO report provides a sound analysis of how the current distance differential structure causes regional tensions between the Upper Midwest and the rest of the country. The historical purpose of distance differentials, which was to encourage the flow of milk out of the Upper Midwest, has been lost as other regions have increased their own production with the advantage of the higher price. Likewise, it seems incongruous to simultaneously encourage the flow of milk out of the Upper Midwest with distance differentials, and discourage the movement of milk into other areas with down allocations and compensatory payments.

Farmers Union shares GAO's concern that Congressional changes in distance differentials made in the 1985 Food Security Act have only added to the imbalance. These changes encouraged production was told to cut back or face continuing support price cuts, and was assessed over $700 million to help pay for the Dairy Termination Program.

We find it unfortunate that in its discussion of the fluid, or Grade A, differential, GAO did not provide any supporting data. The agency claims that a Grade A differential of fifteen cents per hundredweight would be sufficient to encourage production of higher quality milk. This is a substantial decrease over the current $1.04. We would like to know what calculations went into the conclusion that the Class I price is eighty-nine cents per hundredweight too high and that marketing orders' Grade A differentials should be lowered accordingly.

We firmly believe that marketing orders can be improved to bring them up-to-date with current technologies in the dairy industry and current marketing needs of consumers. However, National Farmers Union places top priority on maximizing returns to dairy producers as well as the efficient marketing of milk. The objectives of both the Agricultural Marketing Act of 1937 and the Agricultural Act of 1949, as amended, are broader than just assuring an adequate current milk supply. The 1937 legislation directs the Secretary of Agriculture to set prices at levels that will insure a sufficient quantity of milk, "and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated futre needs and be in the public interest." The 1949 legislation also directs the Secretary to support milk prices at a level not that will not just assure supplies, but will "reflect changes in the cost of production, and assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs." We reject any suggestions that the milk pricing functions under the 1949 Act or the federal milk marketing order system be weakened or terminated.

GAO suggests eliminating the pricing function from marketing orders, presumably by Congressional mandate, and then moving to elimination of marketing orders completely. We cannot agree with this recommendation for several reasons. First, in the name of getting the government out of the milk business, it would have the government take a meat axe to a system that for over fifty years has brought some semblance of national uniformity to an otherwise regionally diverse industry. It would do this without any input from producers. We believe that the interests of dairyn farmers are best protected by producer referenda on proposals to update marketing orders, either under the current order-by-order structure or in a nationwide effort to streamline the system. (By contrast to the GAO report, one of the strengths of S. 1869 is that it does call for producer-elected advisory boards and producer referenda on board recommendations.)

Second, by GAO's own analysis, this option would decrease producer returns in all areas, except over the long term in the Upper Midwest. While the current system discriminates against this region, curing the inequity by decreasing returns for everyone else does not seem like a sound national policy.

Third, in addition to decreasing producer returns, GAO's recommendation would also decrease market orderliness. These two goals are no less important now than they were in the 1930's when Congress passed the Agricultural Adjustment Act of 1933 and the Agricultural Marketing Agreement Act of 1937. GAO states that high percentages of Grade A production, improved transportation and emerging technologies argue in favor of reducing the federal role in milk marketing. But, removing federal orders would result in other states doing what California has already done in self-pricing. Farmers Union feels that the conditions outlined by GAO point to an increase in interstate commerce, which has always been the domain of the federal government. There is a need for uniformity that argues for continuing federal milk marketing orders in the dairy industry.

Fourth, GAO claims that its recommendation would bring down consumer prices, since processors and handlers could pay farmers less. We find little substantiation of this claim in current practice. Producer returns have dropped steadily since 1984 as the dairy support price has been cut by $2.00 per hundredweight. Consumer prices have not come close to a proportionate decline. Further, if federal marketing orders are eliminated, surely something -- either state or regional plans -- will replace them eventually. The market will not function in total disorder. Whatever that structure is will have an effect on consumer prices in the long run. At best, the impact of GAO's recommendation on consumers is indeterminate.

Finally, we disagree with GAO's claim that its recommendation would decrease national production of dairy products. The basis for GAO's statement is that the price of milk would drop. If there is anything that the last five years of the price support program have established, it's that price alone is ineffective in controlling supply. The immediate effect of a price cut in dairy is a supply increase. In the long term, production might go down as more producers are driven out of business, although even GAO admits that comparatively improved returns in the Upper Midwest may result in production increases there.

GAO's recommendation puts producers out of business and disrupts markets, without guaranteeing price benefits to consumers and without assuring taxpayers that surplus production would be brought in line. Farmers Union supports consolidating milk marketing orders when it can be done to improve producer returns and to improve the stability of our milk supply. However, we have no choice but to conclude that GAO picked its recommended option of eliminating marketing orders on the basis of political ideology rather than industry or market needs. The current administration has made no secret of its desire to eliminate government support of agriculture, both here and abroad.

GAO analyzed several other alternatives in preparing its recommendations. Of all the options, establishing production controls was the only one which improved producer returns over both the short and long term in all regions of the country, maintained market orderliness if established at proper levels, and curbed surplus production to the benefit of taxpayers. It is true that controlling production would increase consumer prices, but last year consumer food prices increased 2.5% for dairy products and 4.1% overall while the farmer's share of a food dollar declined, according to USDA's Economic Research Service. While some of that was due to stronger producer prices in cattle and some fruits and vegetables, "the rise in retail food prices was mainly the result of further increases in the farm-to-retail price spread." ("Food Costs. . .From Farm to Retail, USDA, ERS, April 1988, page 1). Consumers have repeatedly expressed their willingness to pay a little more for food if they knew it would keep family farmers in business. Certainly, there are consumers who cannot absorb even a modest increase in food prices, but there are other programs to accomodate their needs, such as food stamps. The National Farmers Union and the Farmers Union Milk Marketing Cooperative believe that a supply management program, either voluntary or mandatory, is the best hope for the future of both producers and consumers of dairy products.

However, such a program must be national in scope. Experts could argue forever over the cause of surplus dairy production. Some say areas that have been increasing production in the face of price cuts and programs to bring supplies down are to blame and should be forced to cut back. Others say that these producers tend to have lower costs of production and can efficiently supply the rest of the country. They would argue that surpluses are caused by higher cost producers in deficit areas who have managed to stay in business, thereby displacing markets, because of high distance differentials and Class I utilization. Still others point out that the entire industry has benefited from low feed grain prices. It is impossible to say that high government purchase levels are the "fault" of one region over another. The major drawback of S. 1869, the Dairy Farm Protection Act, is that it attempts to place regional quotas on Commodity Credit Corporation (CCC) purchases, rather than addressing individual levels of dairy farm production throughout the country.

We are also concerned about the bill's impact on the support price. With chances of passage this year growing remote, and with Secretary Lyng's steadfast refusal to use supply management tools available to him under current law, this legislation would most likely take effect at a support price of $10.10 per hundredweight. The price would not increase until CCC purchases dipped below 2.5 billion pounds milk equivalent. For the bill to accomplish its objectives, it would have to include an immediate restoration of the support price to a more reasonable level.

The major of strength of the bill is its name and avowed purpose. The Dairy Farm Protection Act is an extremely valuable addition to the debate because it reaffirms that keeping farmers in business is a legitimate goal of federal policy. Too often, lately, we have been told that the only true policy goal is the orderly flow of milk around the country. This is certainly important. But we must remember, as many of our GATT partners have, that it is in the national interest to have a healthy agricultural base fueling the rest of the economy. We cannot put programs in place in the name of efficiency that bankrupt rural, agriculturally dependent communities. We cannot ignore the social consequences of our economic decisions. Mr. Chairman, you are to be commended for the end purpose of S. 1869, and we would welcome the chance to work with you and your staff in making the means to that end a national supply management program.

Thank you.

Appendix follows:

APPENDIX

Excerpts from 1988 Policy of National Farmers Union
Adopted by Delegates to the 86th Anniversary Convention
Albuquerque, New Mexico
March 6-9, 1988

Dairy Policy

Farmers Union supports the concept of a long-term supply management program for dairy. We support implementation of either a voluntary or mandatory supply management program to prevent CCC purchases from becoming excessive.

Regrettably, the Secretary of Agriculture missed a major opportunity under the 1985 Act to implement a dairy diversion program to offset effects of the 1988 price cut and to prevent future price support and Gramm-Rudman cuts. We urge other groups to join us in lobbying for dairy diversion.

We support a mandatory program that would go into effect with a simple majority vote of individual dairy producers.

If a mandatory program is in effect, we recommend that:

a. The base be set at the preceding year's production history.
b. Producers who participated in the Dairy Termination Program would have no base history.

The price support level must be established as a percentage of parity. The rate to dairy producers must not be less than 71 percent of parity.

If a mandatory program is not in effect, we recommend the reinstitution of a paid milk diversion program and/or a dairy buy-out program.

* * *

We call on Congress to repeal the Class I differentials legislated by the Food Security Act of 1985 and return the authority to establish differentials to the Federal Milk Marketing Order Administrators, through the hearing process.

We urge acceleration of market order consolidation to achieve uniformity in pricing in regional areas and to maximize net return to producers.

The federal government and milk producing states should be encouraged to enact legislation adopting component pricing of milk, including the use of protein.

* * *

Marketing Orders and Agreements

Federal market orders have proven their worth for producers of milk, fruits, vegetables, and nuts. If there is any legitimate criticism of the market orders, it would be that they do too little, not too much, to enable producers to manage supplies reaching the market, and fall short by a wide margin of achieving the parity prices which are the objective of the law.

The federal market orders, for whatever commodity, are self-imposed regulations, voluntarily chosen by producers and the industry. There are ample means for participating producers to make changes in market order programs or to terminate them if they are not serving a useful purpose. The Secretary of Agriculture can also terminate a market order which does not serve the public interest.

We advocate that USDA budgets contain a proviso prohibiting the Office of Management and Budget (OMB) from interfering with the conduct of market order programs as it has attempted to do in recent years.

To provide United States agricultural producers with a broader, more effective set of stabilization tools, we propose that Congress amend and strengthen the Agricultural Marketing Agreements Act of 1937 to make market order authority available to producers of all farm commodities; to permit use of market proration or supply control measures whenever desired by a majority of producers of a commodity; to provide guidelines for fair bargaining between producers and handlers relative to price and terms of sale; and to authorize pooling of sales proceeds.

Senator CONRAD. Finally we will hear from Robert Rumler. Is that the correct pronunciation, sir?

Mr. RUMLER. That is correct, Mr. Chairman.

Senator CONRAD. Well, I appreciate very much that I got that right. Please go ahead and provide us with your testimony, and again, the prepared testimony will be entered into the record.

STATEMENT OF ROBERT H. RUMLER, PRIVATE AGRIBUSINESS CONSULTANT, CHAMBERSBURG, PA

Mr. RUMLER. Thank you, Mr. Chairman. My background is in the statement, the prepared statement, so I will not go over that.

In September 1987, I was commissioned by the National Commission on Dairy Policy to make a study and an evaluation of the regional concept as a policy direction for its consideration in connection with its responsibilities as set forth in the Food Security Act of 1985.

It was my choice to enlist the aid of four regionally located, highly respected dairy economists to address the issue from the regional perspective but within the context of the industry nationally.

On November 16, 1987, our report was made to the Commission. It is my primary purpose today, Mr. Chairman, to make the complete draft of this report available to this committee for the record of this hearing and for subsequent reference on the subject of regional concept by the committee. Included with the task force report as an addendum piece is a copy of the July 1987 Congressional Research Service's report on the regional concept.

At the time the report was filed with the Commission, certain assumptions had to be made regarding the application of the regional concept, primarily as they would relate to the administration of the dairy price support program. Later it was found that the assumptions were essentially correct as set forth in S. 1869. Consequently, I filed an amended concluding statement with the Commission staff in late December 1987. Now, this report is in the process of being printed and will be available in the near future. I regret that I am able to supply the committee with but one copy at this time.

I have attached to my prepared statement a reprint of a two-part article on the regional concept which was published recently over my byline. The basis for the article is the opening chapter which I personally authored in the task force report. In it, an attempt was made to determine the present programs most specifically involved in the regional concept, to surface current critical areas in those programs, to consider whether or not the programs were correctable and could serve as a framework for dairy policy in the future, to draw the difference between policy on the one hand and program on the other, and to draw a comparison between what might be expected through that approach and the introduction of the regional concept, most particularly as it related to the dairy price support program.

I have no illusions, Mr. Chairman, that the Task Force Report on the Regional Concept was the ultimate determining factor in establishing the Commission's policy position on this matter. Rather, I believe that it stands in support of the position ultimately adopted by the Commission. Members of the Commission exhibited a remarkable degree of objectivity in their considerations and determinations in arriving at policy recommendations which they sincerely believe would best serve the interests of all dairymen and the industry as a whole, nationally. To do so, they had to set aside any personal or parochial interests that they may have harbored at the outset. Not to have done so, they would have failed in their determination to bring to the Congress a unanimous consensus report which the Congress has sought and requested of the industry for many, many years.

I appreciate, Mr. Chairman, the opportunity to make these two items available as a part of the hearing record on regionalization as a concept for future dairy policy and as a reference for consideration of this matter in the future. Thank you.

[The prepared statement and attachment of Mr. Rumler follow:]

Robert H. Rumler

Agribusiness Consultant
P.O. Box 945
Chambersburg, PA. 17201-0945

STATEMENT OF

ROBERT H. RUMLER
PRIVATE AGRIBUSINESS CONSULTANT

to the

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE

with respect to the

REGIONALIZATION OF THE DAIRY PRICE SUPPORT AND RELATED FEDERAL PROGRAMS

in support of the policy position of the

NATIONAL COMMISSION ON DAIRY POLICY

May 11, 1988

Mr. Chairman....Members of the Committee,

I am Robert H. Rumler.

For the past six years I have served in semi-retirement as a private agribusiness consultant almost entirely related to dairy, primarily in the policy area and in matters related to international trade. For nearly forty years preceding my retirement, I served variously as the Chief Executive Officer, the Executive Chairman and the Chairman of Holstein-Friesian Association of America, the world's largest dairy cattle breed organization and the breed which presently produces upwards of 90% of the nation's milk and dominates the dairy cattle industry worldwide.

In September 1987, I was commissioned by the National Commission on Dairy Policy to make a study and an evaluation of the regional concept as a policy direction for its consideration in connection with its responsibilities as set forth in the Food Security Act of 1985. At the time, the concept had developed into a discussion topic, primarily in the Northeast, and the industry was becoming sensitized in that region to the relationship between the trigger mechanism associated with a fixed level of projected CCC purchases of dairy products under the dairy price support program and the mandated reduction of 50 cents per hundredweight in the level of price support. Additionally, the concept was surfaced in testimony heard by the Commission at one or more of its 10 hearings held across the nation between March 2 and August 3, 1987.

It was my choice to enlist the aid of four regionally located, highly respected dairy economists to address the issue from the regional perspective, but within the context of the industry nationally. We were most fortunate to obtain the services of Dr. Andrew Novakovic of Cornell University, Dr. Larry Hamm of Michigan State University, Dr. Harold Harris of Clemson University and Dr. James Gruebele of Dairymen's Cooperative Creamery to serve with me as a Task Force to consider the issue.

On November 16, 1987 the report of this Task Force was made to the Commission. That was the day preceding introduction on the floor of the Senate of the Dairy Farm Protection Act (S-1869) by the Chairman of this Committee.

It is my primary purpose today to make the complete draft of this report available to the Committee for the record of this hearing and for subsequent reference on the subject by the Committee. Included with the Task Force report as an addendum piece is the July 1987 Congressional Research Service's Report for Congress on REGIONAL DAIRY TRENDS AND FEDERAL POLICY by Geoffrey Becker.

At the time the report was filed with the Commission certain assumptions had to be made regarding the application of the Regional Concept, primarily as they would relate to the administration of the dairy price support program. Later it was found that the assumptions were essentially correct (S-1869), consequently I filed an amended concluding statement with the Commission Staff in late December 1987. An identified condensation of that statement is included with the Task Force report which I am presenting to the Committee. It is my understanding that this report is in the process of being printed and will be available in the near future. I regret that I am able to supply the Committee with but one copy at this time.

I have attached to my prepared statement a reprint of a two part article on the Regional concept which was published recently over my byline. The basis for the article is the opening chapter which I personally authored in the Task Force Report. In it an attempt was made to determine the present programs most specifically involved in the Regional concept....to analyze the problem or problems currently associated with these areas....to consider whether or not the programs were correctable and could serve as the framework for dairy policy in the future....to draw the difference between policy on the one hand and program on the other....and to draw a comparison between what might be expected through that approach and the introduction of the regional concept, most particularly as it related to the dairy price support program.

In the interest of time, I will let the article attached to my prepared statement stand as my own statement on future dairy policy as it relates to the price support program.

I have no illusions, Mr. Chairman, that the Task Force Report on the Regional Concept was the ultimate determining factor in establishing the Commission's policy position on this matter. Rather, I believe that it stands in support of the position ultimately adopted by the Commission. Members of the Commission exhibited a remarkable degree of objectivity in their considerations and determinations in arriving at policy recommendations which they sincerely believed would best serve the interests of all dairymen and the industry as a whole, nationally. To do so, they had to set aside any personal or parochial interests they may have harbored at the outset. Not to have done so, they would have failed in their determination to bring to the Congress a unanimous consensus report which the Congress has sought and requested of the industry for a number of years.

Thank you Mr. Chairman for this opportunity to make the two items....The Commission's Task Force Report and my individual convictions on dairy price support policy, a part of the hearing record on Regionalization as a fundamental concept for Federal dairy policy in the future.

Attachments follow:

DISPATCH FROM WASHINGTON

by Robert H. Rumler

Editor's Note: Last September, Chairman Emeritus Rumler was commissioned by the National Commission on Dairy Policy to make an objective evaluation of the proposal to regionalize the operation of federal dairy programs, a concept which was gaining the attention of some dairy interests in the Northeast. Originating in the '86 Senatorial race in Vermont, regionalism was seen as a means to aid Northeast dairymen, and ultimately evolved into a Senate bill—the Dairy Farm Protection Act—which brought it national attention.

Understanding the sensitivity of the issue, Rumler enlisted the aid of four regionally located dairy economists to address the issue from the local perspective, but within the national context of the industry. He was joined in the effort by Dr. Andrew Novakovic of Cornell University, Dr. Larry Hamm of Michigan State University, Clemson University's Dr. Harold Harris and Dr. James Gruebele of Dairymen's Cooperative Creamery.

In mid-November, Rumler made the Task Force report to the Commission. Following is the first of a two-part article abbreviated from the covering section of the report by Chairman Rumler who chose not to publish his thoughts until the official release of the Commission's report, at a Washington press conference on March 31.

Regionalizing Federal Dairy Programs

What's Behind It? Is It A Solution?

Specifically involved in the regionalization issue are two key federal dairy programs: the Federal Milk Market Order Program, which originated in legislation enacted in the mid-1930s, and the 1949 milk price support program, although the price of milk was supported earlier. This combination of price support and marketing orders is found only in the dairy industry.

The Agricultural Adjustment Act of 1949 established the permanent dairy price support program. It remains in effect today, but the parity concept for fixing the level of price support was deleted in 1981. Since October 21 of that year, the dairy price support level has been established by Congress at arbitrary rather than parity levels. In their original design, the two programs were not the result of a clear focus on a carefully planned, long-range dairy policy. Yet they came to be accepted as cornerstones for policy.

The '85 Farm Bill came closest to establishing federal dairy policy. A five-year program, it embraces both the Price Support and Market Order Programs. Whether the redesigning of these programs in the Farm Bill was as effective as it might have been is, in part, the underlying issue of regionalization.

Policy vs Program

Policy is philosophically based...a "road map" for coordinated, consistent, long-range development for any enterprise, including the federal government. It is a necessary foundation to program planning.

Program, on the other hand, is the translation of policy into action...the operational extension of policy on a day-to-day basis.

To the extent this positioning of policy and program is valid is the extent to which one can understand the lack of stability in the dairy industry over the past 10 years. Primary focus here is on the Price Support Program.

Until the '85 Farm Bill, the federal Market Order Program remained rather free of legislative tinkering. Then it became the victim of arbitrary action when the will of the marketplace was set aside in favor of legislated Class I price differentials. This action increased the differentials in 35 orders and specified minimum differentials in all 44 orders, exacerbating the demographic trends within the industry. With a sound dairy policy in place, this probably would not have happened.

"Further" Regionalization

The concept of further regionalization of dairy programs is the child of economics and sociological forces, frustrated by rapidly developing changes working in a dynamic world. It is a struggle between the realism of economic forces in a market-oriented society and the realism of democratic political/social forces in that same society. It has its origin in the long sustained excess of milk supply over domestic demand and the perception that certain aspects of federal programs designed to deal with the situation are inequitable at the producer level. Without an *anticipated* "surplus environment," however, further regionalization would not be an issue.

Further regionalization is presumed to be the division of the country geographically into basic, autonomous dairy regions. Under the support program, each region would be provided a maximum allotment of CCC purchases out of a national cap placed on such purchases. Additional CCC purchases from the region would result in an assessment to producers in the region to cover the cost of those purchases. There would not necessarily be a similarity among the regions as to the programs or procedures within each region.

The term "further" as used here in connection with the two programs is in quotes. A national map of the location and coverage of the 44 Federal Market Orders is the only evidence needed to substantiate the existence of regionalism in one aspect of our milk pricing system. Therein, the regional concept is completely market oriented and directed without arbitrary geographic design or limitation.

Participation in the order program is limited to fluid (Class I) milk. Much of this milk, however, is processed into hard dairy products which are marketed well beyond the normal marketing area. (During 1986, handlers regulated under federal milk orders used 58.7 billion pounds of milk, skim milk and cream in various manufactured products. Producer deliveries used in Class I amounted to 43.2 percent of the total.)

Surplus Environment

"Surplus environment" has paradoxical connotations. There is no surplus of fluid products in the marketplace, yet fluid milk as a raw product may be in surplus. Surplus is expressed in terms of pounds of raw product, yet all surplus in the marketplace is in the form of manufactured products.

Manufactured dairy products are produced: (1) as a by-product of a fluid milk marketing operation; (2) as an extension of a fluid milk marketing operation; and (3) in operations devoted exclusively to their production.

Milk is produced and sold in fluid form in market areas readily identifiable. Processed manufactured products from the same area are not limited in sales to these same markets, nor to markets readily identifiable geographically or regularly to the same markets. The very nature of manufactured products makes them available for any market, domestic or international, where they can be sold at prices competitive with similar products from any other area.

And so we conclude that the market for fluid products as a rule has an established regional connotation. Manufactured products do not. Rather, they enjoy the market wherever it can be found and therefore are national or even international with respect to their market outlets.

The bottom line is that what "surplus" exists is in the form of manufactured dairy products, that manufactured products enjoy a national market, that the accumulative national total of manufactured products represents the available supply for that national market. That which does not find a commercial market is the national "surplus." The location of the processing plants that did the manufacturing of the raw product and the domestic source of that raw product are not relevant. What is relevant, however, is that a certain amount of surplus is needed at various times of the year to balance the supply/demand equation and to provide an adequate supply of milk and dairy products at all times.

This approach to surplus deals with the geographic aspect of the marketplace in connection with the regionalization question. The equally fundamental economic aspects deal with the price/quantity relationship. (This was covered in one of the regionally produced discussion papers, but this evaluation ultimately arrives at the same conclusion.) Neither deals with the less tangible political/social aspects for reasons which become obvious in the discussion of policy guidelines. ☐

DISPATCH FROM WASHINGTON

by Robert H. Rumler

Regionalizing Federal Dairy Programs

What's Behind It? Is It A Solution?

Editor's Note: This is a continuation of the article that appeared last issue adapted from the report of the Task Force he headed for the National Commission on Dairy Policy on the topic of regionalizing federal dairy programs.

Certain policy-like guidelines must be assumed to exist for operating programs to be given consideration. While not intended to be policy recommendations, they could serve that purpose, however. Here, they serve as a base for program direction in this discussion. (The Commission is responsible for policy development.)

1. National Dairy Policy should be long-term in concept, yet provide flexibility in its program translation.

2. National Dairy Policy should be market oriented. This presumes that federal dairy policy will be driven by market forces; i.e. supply, demand, price relationship...the principles of marketplace economics.

3. The function and purpose of the Dairy Price Support Program is to provide economic stability to the industry with consumer security and assurance of an adequate supply of high-quality milk and dairy products for the present and foreseeable future at a reasonable price. Its role is not to serve as an income enhancement mechanism for dairy farmers. This presumes that the support price will not represent the market price for milk over extended periods of time, but effect an orderly adjustment to market-clearing levels or signal needs for additional production through the price mechanism.

4. The responsibility of government is to be certain that the purposes of the price support program are achieved. The role of government is to see that the program functions properly to achieve those purposes. This presumes that government's obligation is limited to the balancing of the national milk supply/demand equation on an annual basis. It does not presume an obligation of government to purchase any specified quantity of dairy products to achieve this end.

5. The Federal Milk Market Order Program is a necessary mechanism through which a cooperative industry/government effort can stabilize the fluid milk markets which generally are localized in nature. This presumes a return to the hearing process with related flexibility vs. rigid, mandated provisions of federal legislation.

It can only be concluded, therefore, that "regionalization" of federal dairy programs as a matter of policy, beyond that involved in the Milk Market Order Program, would be an inappropriate and ineffective response to the administration of the price support program.

The '85 Farm Bill Environment

The industry is currently operating in the policy/program environment of the Food Security Act of 1985. It is being suggested, however, that a new direction in policy needs to be considered...specifically the regionalization of federal programs and more particularly the price support program.

What are the issues which seem to have triggered this situation? Each of the Task Force members provided excellent perspectives on this question from their respective regional locations. This was done in the context of the industry, nationally, and with an understanding of the mix of economics, emotionalism, perceptions and justifiable self-interests involved. Although varied, they contained a commonality.

There are three underlying problem areas each of which contribute to developing industry concern.

1. How the level of dairy price support is determined or set.

2. How the price support filters down to the producer level...how the "make allowance" is administered.

3. Congressional intervention

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into the otherwise localized determinations within the Federal Milk Market Orders.

Four additional points have significance.

1. If the support price in the late '70s had not been politicized and the level since 1980 had not been the result of Congressional action without administrative discretionary authority, there would be no significant surplus problem today.

2. Without an anticipated "surplus environment," regionalization of the industry would not be an issue today.

3. Federal dairy programs must operate in an environment of budgetary constraints. This gives credence to the price support program serving only the purpose set forth in the "guidelines" previously stated. The concept of "decoupling" also underscores that fact.

4. Fairness and equity among all dairymen in the implementation and operation of federal dairy programs is an issue to be reconciled.

Setting the Price Support Level

There are two facets to the issue:

1. The rigidity of mandated cuts and increases without flexibility of discretionary authority. There is no visible relationship to production input costs or other matters related to the supply side of the equation. On the demand side, the trigger mechanism for support price cut and increases is vested in the projected level of CCC purchases with equal rigidity...completely arbitrary at the projected annual CCC purchase levels of five and 2.5 billion pounds, respectively.

Comment: In 1980, the General Accounting Office of the Congress put forth several alternatives for establishing the level of price support. One suggested the use of a comprehensive formula. Presently the concept is gaining support. Such a formula would need to be limited to milk production input factors. It would need to be supplemented by a supply/demand adjuster and discretionary authority within realistic parameters. This envisions further the continuation of a back-up supply control element in current legislation: i.e. the Dairy Termination Program.

2. The five billion plus pound projected annual CCC purchase level triggering a support cut has sensitized producers to CCC purchases...more particularly, to where those purchases are made. The result is a distorted view of "who's producing the surplus." It is the single most significant factor in bringing the regional concept to the forefront.

Comment: The five billion pound trigger level is arbitrary. This is what the government either needs or is willing to buy for its several programs at support level prices. The figure has only secondary relationship to the government's obligation under the support program. It should more accurately be established "as an obligation to balance the national supply/demand equation on an annual basis as a minimum." The projected amount to purchase in any given year will vary and should not serve to trigger fixed cuts or increases in support level. It would be used as one element in establishing the support price.

The Issue of "Make Allowance"

This allowance is intended to compensate the processor for the conversion of the farm product into products that can be stored and otherwise held or disposed of to facilitate the CCC purchase mechanism. It is intended to provide the producer with the established support price for the milk so processed and administered uniformly on a national basis. This appears not to be the case and therefore tends to support the perception of inequity in the program.

Comment: Where a market is provided for the processor by CCC purchase, all such milk should be priced back to the producer on the same basis with respect to the use of federal funds involved. Calculations involved should be uniform nationally and verifiable.

The Issue of Legislated Class I Differentials

Classified pricing and the differential for Class I milk in Federal Order Markets are designed to stabilize the fluid milk supply, market-wide. Provisions within the several markets have been established to apply to individual markets. Under the '85 Farm Bill, specific minimum Class I differentials were set for each Federal Market Order. This was done without the normal scrutiny of the hearing process. The long-time demographic effect on the industry, considered to be adverse, was detailed in the discussion papers where it is believed that it will negatively impact on most areas of the country.

Comment: The '85 Farm Bill establishes the minimum differentials for a two year period and thereafter "unless modified by amendment to the order involved." While the hearing process has been criticized justifiably as being excessively slow in its response, particularly with respect to findings and decision, the legislative route is not likely to be an improvement. Quite to the contrary. A return to the hearing process with improvement in response time can be justified.

In this section, an effort has been made to identify briefly the major issues of concern believed to underlie efforts to support further regionalization of the industry relative to two key federal dairy programs. Comments are intended to be a simplified response or reasoned corrective approach to each issue. There may be other alternatives, but this suggests that at least one approach to each issue exists within the context of the policy-like guidelines and outside the structural change implicit in regionalization.

In Conclusion

In the interest of being more explicit, this section was revised and updated in mid-December.

Surfacing three areas of current industry concern related to federal dairy programs is not meant to suggest that there are not others. Those, however, are more of an individual nature relating to fairness, equity or perceived inequity, disassociation from "the problem," and equal treatment under similar circumstances.

Dairymen generally accept the realism of the driving forces of market-place economics. They recognize and accept the competitive factors among producers, locally and nationwide. They recognize and understand the basic economic factors involved in

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the changing demographics of the industry.

Assuming that the fundamental issues have surfaced herein and the policy-like guidelines are acceptable, what is the best approach or direction to be taken, long-term, to implement programs designed to translate those policies into effective, acceptable operation?

One obvious response is to refine established programs to meet changing needs as has been done since the price support and federal order programs were initiated. This would not require a major overhaul of the operating procedure or the administrative structure. The preceding sections deal broadly with that approach.

"Further" Regionalization is another approach...

National dairy philosophy does not and should not espouse regional self-sufficiency as a policy goal. Yet, "regionalizing" the price support program has as its basis self-sufficiency within regions...a completely unmanageable and unattainable situation so far as hard products are concerned.

The regional idea is in fact an attempt to insulate one or more geographic areas of the country from economic forces which it is anticipated would continue to effect demographic changes in the industry, nationally. To achieve such an objective, it must be assumed that producers within each area will behave cooperatively; i.e. will not expand production if granted protection from competition...or, will limit production to avoid imposition of assessments...or, will otherwise voluntarily act in the interest-of-the-whole within the area. Against this, there is ample evidence that production and related efficiencies vary more widely among producers and within regions than they do among regional averages. The consequence...efficient producers within the more "protected" regions would have an added advantage and incentive to expand. Expansion in milk production output is attributable to economic efficiencies far more than discriminatory pricing policies. Further, producer assessments of the magnitude expected have not been found to be a deterrent to increases in production, nor are they more equitable among producers within regions than they are nationally.

The volume of sales to the CCC from a state or region is an unreliable indicator, in itself, in establishing guilt for the larger-than-acceptable, market-dictated volume of milk production. Hard dairy products are manufactured in all major milk producing areas for the national market.

Regionalization introduces another administrative level into program operation, probably an irreversible operational procedure. It would introduce a strong competitive factor among regions in the national market place, setting aside the national characteristic of the market outlet for hard dairy products.

Its ramifications could be far-reaching and its impact somewhat dramatic, although it is fundamentally a change in the administration and operational procedure of the support program.

The stated goals of the concept are very broad and to date, quite general...to hold down (limit) the federal cost of the price support program...to "protect dairy farming across the country"...and to have a program that is fair.

Except as a means of capping government costs, it is unlikely that the intent of the other goals are achievable within the now proposed legislation. Capping costs could be achieved much more easily and directly than by the means proposed and with less disruption to the industry.

Fairness is a highly commendable goal, but the question is, "fair to whom" since fairness is a matter of individual perception. Equal opportunity on a level playing field is a reasonable measure of fairness for government to achieve.

"Protecting the family farm" is equally commendable if one knows what it means and what is to be protected. Then it must be determined if the price support program is the appropriate vehicle and has the capability to do so. On both counts this is questionable.

As for a "new approach to farm (dairy) policy," the idea is narrow in focus, too parochial in philosophy and too simplistic in concept.

It can only be concluded, therefore, that "regionalization" of federal dairy programs as a matter of policy, beyond that involved in the Milk Market Order Program, would be an inappropriate and ineffective response to the administration of the price support program and matters related to balancing the supply/demand equation for the nation's milk industry. It fails to address the fundamental issues and weaknesses in the current programs or to provide a viable alternative to their correction as indicated as an earlier possibility.

Senator CONRAD. We appreciate that very much. I have often been in a situation like this where I have testified and have heard somebody else say something that I feel a burning need to respond to, and I just want to give this panel that opportunity.

If you have heard something here from one of the other witnesses that you feel very strongly about and would like an opportunity to respond to, you are welcome to do that. So if anyone on this panel has heard something which one of the other witnesses said that you feel strongly about rebutting, or you feel you have heard a statement that you want to give support to, we would be happy to give you this opportunity now.

Yes, Tom.

Mr. TRANTHAM. I have one thing I would like to bring up. The point on a base program or a control production program and the cost of the farmer getting into it. Under the program that we have submitted, there would be no cost. The base would go with the farm, and as the increased need of production, the need for the base then would be established. The young farmers would be able to apply for that base and go into farming. And that base would be at no cost whatsoever.

Then, also, if we had cost, it would not be involved in production at all, is what I am trying to say on that base. There would be no cost to it, and that would not be a factor.

Senator CONRAD. If you have an established base, and obviously it is designed to meet demand, how does someone new who wants to get in get base? Someone else has to go out of business for them to get base, or what is the mechanism by which someone gets base?

Mr. TRANTHAM. Well, of course, there would be some going out of business, especially with the older age of dairy farmers today. There are going to be a lot going out of business. The average age is almost 60 in South Carolina right now.

So that would be one way. Then also, as we bring this surplus out, the need would increase due to, number one, our advertising program. We have seen a tremendous increase in dairy products, usage of dairy products. We have also found a lot of the mistold information about high cholesterol and all that with proper use of dairy products that that is not a true fact.

And the health need of dairy products we are also going to see an increase in the usage of it. So there is going to be an increase in usage, number one. There is also going to be an increase of population.

Senator CONRAD. That would be the source of the additional base?

Mr. TRANTHAM. Yes, sir.

Senator CONRAD. All right. Cheryl, you had an observation?

Ms. COOK. Yes. I will just address the base question for a minute as well. Whether you are talking about attaching a value actually to the base or capitalizing the value of a base into a farm or however you want to do it. First, you have to make a judgment call: Is it bad to discourage new entrants into the business if the purpose of the supply management program is to keep supplies down?

If you determine that, yes, in fact, this is bad and we want to do something about the fact that new entrants are discouraged, I think there are creative ways to do that. It is not necessarily the end-all of a quota program. As part of a rural development package, for example, older farmers could be convinced to work with younger farmers and get some economic advantage for the older guy. Get some base for the younger guy and gradually transfer that farm.

There are ways that base can be set aside specifically for new entrants and younger farmers. And finally I would suggest that the idea of gradually acquiring base is certainly not foreign to farm programs. We do that in other areas.

Senator **Conrad**. All right. Dr. Ortego.

Dr. **Ortego**. Yes, a number of witnesses have commented about the increasing differentials at the last act. I want to make two points on that.

Senator **Conrad**. Go ahead.

Dr. **Ortego**. The primary increases were in the Southeast. At the time we were short of milk, and we continued to be short and production in the Southeast, in total, is still running well below a year ago. Florida's production is up, but Florida sales are up as much. And last year, this past year after the differentials and they brought in more milk from the Midwest than ever before. And they could not get it to Florida at the local price.

It cost more to bring it in than the local prices. The point here is we are not in a position of getting an adequate supply still, and we still believe that price is the best adjuster because it is very impartial.

And while, let us say, the price increased in the Southeast, the support price went down to $13.10 to $10.60 which is $2.50, the average drop in the Southeast was $1.75 when you take the adjustment for the differential. So we just had less of a drop but it was quite a drop.

Senator **Conrad**. All right. Anyone else who would like to make an additional comment? Yes, sir.

Mr. **Shupe**. Senator, in regard to this base problem, what are you going to do? Are you going to tell the corporation it cannot buy bases? Are you going to tell the corporation it cannot be a—I am talking about a large food corporation or a large farming agri-farm business—that they cannot go into a partnership arrangement with a family farmer who buys the base and holds it and operates it?

In other words, I think what you are going to do there is, whether you like it or not, it will be capitalized into the value of the land, and as the man said from Canada, the young farmer that wants to go into business, what did it cost him? $750,000 to buy the base, I guess, before he bought a cow, and he had only 30 cows or something like that.

I do not know about this. I think it is a bad way to go. I think there are other ways to go to help farmers and to lower surplus costs of milk. This is not the way to do it.

Senator **Conrad**. All right. Anyone else that has a comment? Tom.

Mr. **Trantham**. The problem I have now is that I have over a half a million dollar farm I am getting ready to lose. So I would rather pay for some base and have a profit farming than to lose what I have got with nothing that I will have, what I will receive from all this.

So the program we have got is not working, and there has to be a price to where we can live with it, and a basis, we feel there is no other way because if you open the door you get the price up high. Then we will have thousands of people going into the dairy business again and driving up our surplus product. So there has to be a control, as with the peanut and the tobacco program has worked well that was brought up here.

Senator CONRAD. All right. Let me just again thank all of you for taking the time to appear here. It has been excellent testimony. It is going to be very helpful to the committee, and we very much appreciate your participation. With that, we will close this hearing.

[Whereupon, at 12:47 p.m., the committee adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF

JAMES P. (TOM) CAMERLO
PRESIDENT
NATIONAL MILK PRODUCERS FEDERATION

To

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE

With Respect To

THE GAO REPORT ON
FEDERAL MILK MARKETING ORDERS

STATEMENT OF JAMES P. (TOM) CAMERLO
PRESIDENT
NATIONAL MILK PRODUCERS FEDERATION
With Respect To
THE GAO REPORT ON FEDERAL MILK MARKETING ORDERS

Mr. Chairman:

I am Tom Camerlo, President of the National Milk Producers Federation. I also serve as President of Western Dairymen Cooperative, Inc. a 1500 member co-op serving dairy farmers primarily in Colorado, Utah, Idaho and Wyoming. I appreciate the opportunity to present to the Committee the views of the National Milk Producers Federation on the federal milk marketing order program and the recent report to the Congress on this program by the General Accounting Office.

The Federal Milk Marketing Order Program is authorized by the Agricultural Marketing Agreement Act of 1937, as amended. The program facilitates the marketing of milk, which is a commodity plagued with inherent instability, both physically and economically, due to its bulky, perishable nature, the seasonal nature of its production and the varying patterns of its demand.

The program promotes orderly marketing of milk by applying a classified price system, which places milk used in fluid products in a higher price class and milk used in various manufactured products in lower classes. The orders establish minimum prices for milk in each use class to reflect local and general economic conditions affecting supply and demand for milk so as to assure an adequate supply of fresh, wholesome milk for beverage purposes and allow for the orderly disposition of milk in excess of such needs.

The program eliminates the ruinous competition for milk markets by providing for a uniform or "blend" price to all producers who supply a given market. It provides accurate and detailed market information on the purchase and sale of milk in all Federal milk marketing areas. It has assured consumers an adequate supply of pure and wholesome milk for fluid use at reasonable prices.

The National Milk Producers Federation strongly supports the basic federal legislation authorizing the Federal Milk Marketing Order Program, which facilitates the orderly marketing of milk.

The Federation devotes considerable time and effort to evaluating and monitoring the marketing order program on an ongoing basis to ensure that the program continues to provide for the efficient marketing of milk and dairy products. The Federation pursues modifications of order provisions from time to time to ensure that the program continues to provide for equitable treatment of producers and other segments of the dairy industry.

It was our hope that the GAO report would provide the Congress and the industry with a reasonable blueprint for fine-tuning the federal milk marketing program in the public interest. However, I must report to you, Mr. Chairman, that we were seriously disappointed in this hope.

Instead of a blueprint, the GAO report is nothing more nor less than a politically-motivated attack on the program, unsupported by in-depth, objective analysis, and culminating in the recommendation that federal milk marketing orders be "eliminated completely." Put another way, the basic argument of the GAO is simply this: regulation is bad, deregulation is good; therefore, deregulate.

This attack on the order program is, needless to say, fundamentally at odds with the basic policies of the National Milk Producers Federation, but also at odds with the economic realities involved in the marketing of milk.

The basic conclusion of the GAO report is summed up in the following statement:

> "The milk marketing order pricing policies are not based on current dairy market conditions for the following reasons:
>
> * The grade A differential is far higher than the added cost of producing grade A instead of grade B milk.
>
> * Distance differentials are no longer appropriate.
>
> * Marketing order provisions ... effectively prohibit the use of reconstituted milk ..."

Based on these conclusions, the GAO claims that federal milk market order pricing encourages excess milk production, thereby increasing government purchases of dairy products under the federal dairy price support program and thus contributing to the federal budget deficit.

These are serious charges which do not stand up in the light of objective analysis. One of the fundamental weaknesses of the GAO analysis is its failure to fully recognize that the Class I differentials under the orders, which are prices that processors of fluid milk pay, at their plants, for milk used in fluid milk products, must cover a number of marketing costs involved in providing an adequate supply of fluid milk to such plants.

Supplying fresh fluid milk to a plant in the quantities, and on the schedule required to allow the plant to operate efficiently generates a number of costs related to transporting and often temporarily storing the milk actually delivered. It also generates costs associated with disposition of milk required to service a market during peak fluid milk demand but not needed during a particular day, week, or season of the year. All of these costs must be reimbursed from the returns received from Class I milk prices before those returns are distributed to milk producers.

Furthermore, milk producers receive prices that reflect returns from the fluid markets only as a weighted-average, or "blend" price, with the remainder of the weight being the manufacturing grade milk price, and from which are deducted the costs associated with providing milk for fluid uses.

Grade A Differentials

In light of the foregoing, the GAO conclusion that the grade A portion of the Class I differentials are higher than the added cost of producing grade A instead of grade B milk completely ignores the fact that only a portion of the grade A differential is actually passed on to individual milk producers in their milk checks in the form of the blend price.

The GAO conclusion regarding the grade A portion of the Class I differentials also ignores the fact that the major portion of the grade A differential actually covers off-farm costs of providing a delivered supply of grade A milk to fluid processing plants. Only a small portion of this differential covers the differences in producing grade A as opposed to grade B milk.

Distance Differentials

The GAO claims that the distance differential portion of the Class I differentials have caused excessive expansion of milk production in areas distant from the Upper Midwest, particularly those areas where the Class I differentials were increased under the provisions of the Food Security Act of 1985.

This is an issue which is generating a lot of heat but, we feel, too little light at the present time. Many who support the GAO's claim tend to point to developments in Texas as proof that the differentials are indeed causing milk production to expand. However, these same proponents are strangely silent when it comes to explaining why it is that such states as Louisiana and Mississippi, where the differentials were increased significantly under the 1985 farm bill, are experiencing reductions in overall milk production. They are also silent when it comes to explaining why production is increasing somewhat faster than the national average in many states in the Northwest and West where Class I differentials were unchanged by the 1985 farm bill. Moreover, California, operating under the provisions of its state marketing order, has actually experienced a significant reduction in its effective Class I differential in recent years.

The real key to explaining shifts in regional milk production patterns in recent years lies in changes in the structure of the cost of producing milk, particularly the reduction of feed prices to below-cost levels following the reduction of loan rates for the major grain crops under the provisions of the Food Security Act of 1985.

Since grain prices are already starting to increase again in response to the supply management provisions of the 1985 farm bill, we question the wisdom of making major changes in the federal milk marketing order pricing provisions in response to a situation involving milk production costs that is not only temporary but already in the process of resolving itself.

Reconstituted Milk

The GAO report is critical of the impact of the down allocation and compensatory payment provisions of milk marketing orders on the use of reconstituted milk. However, the report fails to acknowledge that the establishment of minimum prices for milk in different uses under the orders, which was clearly the intent of Congress in the Agricultural Marketing Agreement Act of 1937, which authorizes federal orders, would be completely undermined by deregulating the use of reconstituted milk.

As mentioned earlier, the National Milk Producers Federation had looked to the GAO report as a vehicle for fine-tuning the federal order program. We feel that one of the major purposes of the federal milk marketing order program is to enhance the efficiency of servicing fluid milk markets and to promote equity among producers and processors of milk. We also feel that the order program is fully capable of accomplishing these purposes, but that the current administration of the program has not allowed the program to do so in certain respects.

Rather than pointing this out, the GAO report simply dismisses the milk marketing order program because it is a form of regulation. Mr. Chairman, the Congress deserves better, the industry deserves better, and the public deserves better.

Since there are important issues deserving attention which may improve the operation of federal milk orders, the National Milk Producers Federation has decided to convene a forum, or study group, to attempt to shed some solid analytical light, shorn of political rhetoric, on the federal order program. We plan to bring together experts on the federal orders from cooperatives, processors, the Department of Agriculture, and the universities to accomplish this purpose. We will advise the Congress of the outcome.

Thank you.

II

100TH CONGRESS
1ST SESSION

S. 1869

To amend the Agricultural Act of 1949 to protect the family dairy farm by establishing a regional dairy production stabilization program, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 17 (legislative day, NOVEMBER 12), 1987

Mr. LEAHY introduced the following bill; which was read twice and referred to the Committee on Agriculture, Nutrition, and Forestry

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A BILL

To amend the Agricultural Act of 1949 to protect the family dairy farm by establishing a regional dairy production stabilization program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Dairy Farm Protection Act".

SEC. 2. REGIONAL DAIRY PRODUCTION STABILIZATION PROGRAM.

(a) IN GENERAL.—Section 201(d) of the Agricultural Act of 1949 (7 U.S.C. 1446(d)) is amended by striking paragraphs (1) and (2) and inserting in lieu thereof the following new paragraphs:

"(1)(A) During the period beginning on January 1, 1989, and ending on December 31, 1995, the price of milk shall be supported as provided in this subsection.

"(B) During the period beginning on January 1, 1989, and ending on December 31, 1995, the price of milk shall be supported at a rate equal to the support price rate in effect immediately prior to the date of enactment of the Dairy Farm Protection Act.

"(C) If for any of the calendar years 1989 through 1995, the level of purchases of milk and the products of milk under this subsection (less sales under section 407 for unrestricted use), as estimated by the Secretary on January 1 of such calendar year, will not exceed 2,500,000,000 pounds (milk equivalent), the Secretary shall increase by 50 cents the rate of price support for milk in effect on such date.

"(D) The price of milk shall be supported through the purchase of milk and the products of milk.

"(2)(A) During the period beginning on January 1, 1989, and ending on December 31, 1995, the Secretary shall establish and carry out a regional dairy production stabilization program as provided in this paragraph.

"(B)(i) Under the program established by this paragraph, the Secretary shall designate at least 6, but not more than 10, dairy production regions in the United States.

"(ii) In establishing each region, the Secretary shall take into consideration the location of existing milk marketing order regions and historical transportation and distribution patterns of fluid milk and milk products.

"(iii) The Secretary shall establish, for each region, an authorized purchase level for milk products purchased under this subsection. Such authorized purchase level shall equal to the product obtained by multiplying—

"(I) the product obtained by dividing the average of the quantity of milk and the products of milk purchased under this section from the region during 1986 and 1987 by the average of the total quantity of milk and the products of milk purchased nationally under this section during 1986 and 1987; by

"(II) 5,000,000,000 pounds milk equivalent units.

"(iv) If, for any of the calendar years 1989 through 1995, the level of purchases of milk and the products of milk under this subsection (less sales under section 407 for unrestricted use) from any region exceeds the authorized purchase level established for such region, the producers of milk in such region shall pay an assessment, in accordance with subparagraph (C).

"(C)(i) The assessment provided for by this paragraph shall only be for such times and in such amounts as is necessary to offset the cost associated with the purchase under this subsection of any milk or milk product produced in the region in excess of the authorized purchase level established for the region.

"(ii) The assessment shall be collected and remitted to the Commodity Credit Corporation, at such time and in such manner as prescribed by the Secretary, by each person in the region making payment to a producer for milk produced in the region and purchased from the producer, except that in the case of a producer who markets milk of the producer's own production directly to consumers, such assessment shall be remitted directly to the Commodity Credit Corporation. The assessment shall be levied on the quantity of milk sold in the region for commercial use during an assessment period.

"(D) If the Secretary determines that purchases of milk and milk products in a specific region in excess of the authorized purchase level were caused by the shipment into such region of milk and milk products produced in another region, the Secretary may allocate any portion of such purchases determined appropriate to the region in which such milk and milk products were produced.

"(E)(i) In carrying out the program provided for by this paragraph, the Secretary shall establish regional dairy production boards that shall consist of not less than 5, nor more than 11, members.

"(ii) The responsibilities of a board established under this subparagraph shall include—

"(I) investigating and reporting to the Secretary allegations concerning the shipment of milk and milk products from one region to another and evaluating the impact of such shipments on the level of purchases of milk and milk products in the region; and

"(II) developing and recommending to the Secretary alternative programs designed to reduce surplus milk production in the region or to ensure that costs associated with the purchase of quantities of milk or milk products in excess of the region's authorized purchase level are not borne by the Commodity Credit Corporation.

"(iii) Notwithstanding the foregoing provisions of this paragraph, the Secretary may implement on a regional basis an alternative dairy production stabilization program recommended by a regional board in accordance with this subparagraph and approved by a majority of the milk producers in the region through a referendum. Such alternative dairy production stabilization program shall be designated to carry out the purposes of this paragraph, including the reduction of purchases of milk by the Commodity Credit Corporation to levels not in excess of 5,000,000,000 pounds milk equivalent units. The Secretary may issue such rules and regulations as may be necessary to carry out such regional program.

"(iv)(I) The members of each regional board shall be elected by a referendum conducted by the Secretary of all milk producers in the region.

"(II) Prospective regional board members shall be nominated by eligible organizations certified under section 114 of the Dairy Production Stabilization Act of 1983 (7 U.S.C. 4505), or, if the Secretary determines that a substantial number of milk producers in a region are not members of, or their interests are not represented by, any such eligible organization, by such milk producers in a manner prescribed by the Secretary.

"(III) The term of appointment to the regional board shall be for 2 years with no member serving more than 2 consecutive terms, except that initial appointments shall be proportionately for 1-year and 2-year terms. Regional board members shall serve without compensation, but shall be reimbursed for their reasonable expenses incurred in performing their duties as members of the regional board including a per diem allowance as recommended by the regional board and approved by the Secretary.

"(v) In carrying out its responsibilities under this paragraph, a regional board may consult with, and obtain information from, the Administrator of the Agricultural Stabilization and Conservation Service, the Administrator of the Agricultural Marketing Service, and other available sources of information.".

(b) CONFORMING AMENDMENT.—Section 201(d)(3) of such Act is amended by striking out subparagraph (N).

SEC. 3. RECORDS AND REPORTS.

Section 201(d)(4) of the Agricultural Act of 1949 (7 U.S.C. 1446(d)(4)) is amended by striking out the first sentence and inserting in lieu thereof the following new sentence: "Each producer who markets milk, each person who sells milk or milk products to the Commodity Credit Corporation, and each person required to make payment to the Corporation or collect assessments under this subsection shall keep such records and make such reports, in such manner, as the Secretary determines necessary to carry out this subsection.".

SEC. 4. MARKETING PENALTIES.

Section 201(d)(5)(B)(i) of the Agricultural Act of 1949 (7 U.S.C. 1446(d)(5)(B)(i)) is amended by striking the first sentence and inserting in lieu thereof the following new sentence: "Each person who fails to remit to the Commodity Credit Corporation the funds required to be collected and remitted by paragraph (2) or who fails to carry out such person's obligations under any regional program established in accordance with paragraph (2)(E)(iii) shall be liable, in addition to any amount due, for a marketing penalty at a rate equal to the support price for milk in effect at the time the failure occurs on the quantity of milk as to which the failure applies.".

SEC. 5. REGULATIONS.

The Secretary of Agriculture may issue such regulations as are determined necessary to carry out this Act and the amendments made by this Act.

SEC. 6. EFFECTIVE DATE.

This Act and the amendments made by this Act shall become effective on January 1, 1989.

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